Canadian Competition Law and Policy at the Centenary

edited by
R.S. Khemani
and
W.T. Stanbury

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R.S. Khemani
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W.T. Stanbury

The Institute for Research on Public Policy
Halifax, N.S.
1991

Dedication

This volume is dedicated to the memory of
Bruce C. McDonald
He died tragically in an automobile accident
in 1991. His contributions to Canadian competition
law and policy will long be remembered.

Bruce was truly a scholar and a gentleman.

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Acknowledgements

This volume and its companion volume, *Historical Perspectives on Canadian Competition Policy* (Halifax: The Institute for Research on Public Policy, 1991), which we also edited, originated at a lengthy dinner we had with Roy Davidson late in 1988. The issue we discussed was how to mark the centenary of Canada's first competition legislation which was enacted in 1889, a year before the much more famous *Sherman Act* in the U.S.. We agreed that the importance of the occasion merited a national conference and one or more volumes of papers analyzing Canadian competition policy in both historical and contemporary terms. Thus began the task of recruiting people to help organize the conference, prepare and deliver papers, to act as commentators on the conference presentations, and to contribute money to finance the deficit associated with the conference and the publications. The need for subsidies reflects the fact that competition policy is a public good and it is of direct and deep interest to only a fairly small number of people.

Yet, in fairly short order we were able to recruit three major sponsors who provided both financial and other resources. We are pleased to acknowledge the substantial support of the following organizations:

- Bureau of Competition Policy
  Department of Consumer and Corporate Affairs
  Ottawa

- Centre for International Business Studies
  Faculty of Commerce and Business Administration
  University of British Columbia

- The Institute for Research on Public Policy

The balance of the deficit was defrayed by generous contributions from nine major Canadian law firms:

- Bennett Jones (now Bennett Jones Verchere)
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- Ogilvy Renault
- Phillips & Vineberg

We gratefully record our sincere appreciation for their support. In addition, partners from each firm participated in the Conference in a number of ways.

Dr. David Conklin of the National Centre for Management Research and Development at the University of Western Ontario was IRPP's representative on the coordinating committee along with the editors. He had the onerous job of handling the logistics of the Conference, and ensuring that expenses did not exceed revenues from ticket sales plus donations from the sponsoring organizations. Furthermore, the Institute agreed to publish the two volumes of papers associated with the project.

Margaret Sanderson of the Bureau of Competition Policy did an outstanding job helping the coordinating committee with the myriad details involved in arranging for the two-day conference (held in Toronto on October 24-25, 1989), featuring scores of speakers, including a number from the U.S., Europe and Australia.

In organizing and presenting the Conference, a number of academics, lawyers, and public servants from both Canada and abroad gave generously of their time and talent. We are pleased to acknowledge the assistance of Donald Baker, Jeffrey Bernstein, Serge Bourque, Bill Brock, Charles Dalfen, Klaus Decker, Jonathan Faul, Christopher Green, Abraham Hollander, John L. Howard, Lawson Hunter, Hudson Janisch, Jean-Pierre LeGoff, Marilyn MacCrimmon, Don McFetridge, Frank P. Monteleone, Francois Rioux, Thomas Ross, J. William Rowley, David Rutenberg, Sandra Sutherland, Frederick Warren-Boulton, Leonard Waverman, and Howard Wetston.

Two people contributed a great deal to the production of the two volumes associated with this project. Meg Fellowes helped with the proofreading and checked many of the references. Sandra Carter did an outstanding job in "word processing" the manuscripts through several rounds of editing and revisions into camera-ready form.

Finally, we wish to thank our authors without whose efforts these volumes could not have been produced. They endured considerable delays while we were working on other projects, although we have tried to update the papers to reflect developments since the revised but not final versions of the papers were received in 1990. The usual caveat applies.

R.S. Khemani
W.T. Stanbury

Foreword

In 1889, Canada was the first western industrialized nation to enact legislation designed to prevent firms from forming agreements in restraint of trade. More than a century later, the conspiracy provisions remain at the core of competition legislation. The role of competition policy, however, has expanded significantly with the development of the Canadian economy. Along with monetary, fiscal and trade policy, competition policy in Canada, as well as in other countries, has become an integral part of the general framework of policies promoting structural adjustment, international competitiveness, economic growth, and price stability.

The importance of competition policy is heightened when considered in the context of an increasingly less regulated economic environment. It has been widely documented -- including in books published by the Institute -- that government intervention in the marketplace tends to induce distortions in economic performance. However, these distortions cannot be corrected simply by reducing regulatory constraints on business without simultaneously strengthening the forces of competition. It is worth noting that at the Toronto Economic Summit held in June 1988, the G-7 countries first explicitly enunciated the goal of intensifying both individual and collective efforts to remove unnecessary controls and barriers to the operation of competitive market forces, and to rely on increased competition to achieve economic efficiency and adaptability. These objectives have been re-affirmed in subsequent summit meetings. Moreover, as Michael Porter and others have emphasized, with the global scope of many markets for goods, services, and capital, a high level of domestic competition and inter-firm rivalry is essential for sustained advantage in international trade.

It may be recalled that shortly after the end of World War II, steps were taken to enact competition legislation in (West) Germany and Japan as part of the set of reconstruction measures. Competition policy has also been recognized as an important element in the economic and political reforms in Eastern Europe and even the Soviet Union. Czechoslovakia, Hungary, Poland and the Soviet Union have recently adopted or have pending "antimonopoly" legislation as they move toward a much more market-oriented economy. Simply privatizing state monopolies will not diffuse ownership and market power, foster competition and stimulate innovation. Effective competition law is necessary in order to provide a framework for business conduct, to protect consumer interests, and to maximize economic welfare.

Over the past 13 years the Institute for Research on Public Policy has published seven volumes on Canadian competition policy -- a list of relevant publications can be found at the end of this book. These span, as can be seen, a wide range of studies and commentaries on the functioning of markets and legislative or regulatory initiatives to discipline the exercise of market power, particularly in the protracted efforts of the federal government throughout the 1970s and 80s to adapt its competition policies to the needs of a more interdependent and technology-intensive economy.

The major reforms in Canadian competition legislation (e.g., those dealing with mergers and abuse of dominant position -- now enshrined in civil law) were not enacted until 1986 when the *Competition Act* replaced the venerable *Combines Investigation Act*. The new law immediately had to cope with the largest merger boom in Canadian history. The scores of very large and hundreds of smaller mergers -- together with the globalization of financial markets and efforts to reform federal and provincial regulations governing financial institutions -- prompted considerable concern about the implications of these developments. IRPP sponsored a national conference in March 1987 from which emerged a large proceedings volume entitled *Mergers, Corporate Concentration and Power in Canada*, published in 1988.

To mark the centenary of Canada's first anti-combines or competition legislation, the Institute, together with the Bureau of Competition Policy and the University of B.C., and with financial contributions -- gratefully acknowledged -- from nine major law firms, sponsored a national conference in October 1989. From the papers presented at the conference and commissioned for the occasion, R.S. Khemani and W.T. Stanbury have produced two volumes. The present volume and its companion volume, *Historical Perspectives on Canadian Competition Policy*, represent the culmination of the Institute's involvement in this area.

The centenary of competition law and policy in Canada provided an opportunity to trace the roots of this important public policy, analyze its evolution, assess its effects and speculate about its future. Readers will note from the diversity of views presented in these volumes that the debates and challenges confronting competition policy continue. The central role played by competitive forces in a free market economy means that competition policy needs to be reassessed and modified periodically in light of changing economic conditions.

In each of its publications on competition policy, the Institute has sought to stimulate and inform public debate on this important issue by presenting a variety of viewpoints. Even more vital than competition in the market for goods, services and capital, competition in the marketplace of ideas remains the key to effective public policy. The Institute hopes that these two volumes will help to illuminate the complex problems entailed in protecting individuals from the abuse of market power.

Rod Dobell
Victoria
August 1991

Avant-Propos

Le Canada a été le premier des pays occidentaux industrialisés à mettre en vigueur, dès 1889, une législation pour empêcher les entreprises de former des ententes visant à entraver le libre jeu de la concurrence. Plus d'un siècle après, les clauses relatives aux coalitions sont toujours à la base de la législation sur la concurrence. Toutefois, avec l'expansion de l'économie canadienne, le rôle de cette législation s'est accru d'une manière considérable. Que ce soit en matière de concurrence, de fiscalité ou dans le domaine monétaire, la politique du Canada, aussi bien d'ailleurs que celle d'autres pays, est devenue partie intégrante de toute une infrastructure réglementaire destinée à favoriser les ajustements structurels, la concurrence internationale, la croissance économique et la stabilité des prix.

L'importance de la politique en matière de concurrence se trouve renforcée quand on l'envisage dans un contexte économique de moins en moins réglementé. Il a été largement établi, y compris dans des études publiées par l'Institut, que l'intervention du gouvernement sur le marché tend à produire des distorsions dans les rendements de l'économie. Ces distorsions, cependant, ne peuvent pas être corrigées simplement par un assouplissement des contraintes réglementaires qui pèsent sur le monde des affaires, sans que soient simultanément renforcées les forces de la concurrence. Il est intéressant de remarquer que, lors du Sommet économique de Toronto de juin 1988, les pays du Groupe des sept ont expressément stipulé qu'il y avait lieu d'intensifier les efforts individuels aussi bien que collectifs afin de supprimer les contrôles et obstacles inutiles gênant le bon fonctionnement des forces concurrentielles du marché, et de s'appuyer sur une concurrence accrue, de manière à acquérir l'efficacité et la souplesse économiques qui s'imposent. Ces objectifs ont été de nouveau formulés lors des réunions au sommet ultérieures. En outre, comme Michael Porter et d'autres l'ont souligné, étant donné le caractère global de nombreux marchés dans les secteurs des biens, des services et des capitaux, un haut niveau de concurrence interne et de rivalité entre entreprises s'avère indispensable si l'on veut avoir des chances durables en matière de commerce international.

Il y a lieu de se rappeler que peu de temps après la Seconde Guerre mondiale, une législation sur la concurrence avait été instaurée en Allemagne (de l'Ouest) et au Japon, dans le cadre des mesures de reconstruction de l'époque. L'Europe de l'Est et même l'Union soviétique ont également reconnu l'importance d'une législation sur la concurrence pour les réformes économiques et politiques en cours. Dans leurs efforts d'orientation vers une économie de marché, la Tchécoslovaquie, la Hongrie, la Pologne et l'Union soviétique ont récemment adopté, ou sont en train de le faire, une législation «antimonopole». Mais la simple privatisation des monopoles d'État ne suffira pas pour établir la propriété privée et l'économie de marché, encourager la concurrence et stimuler l'innovation : une législation sur la concurrence est nécessaire si l'on veut aménager un cadre adéquat pour la conduite des affaires, la protection des intérêts des consommateurs et un rendement économique maximum.

Au cours des 13 dernières années, l'Institut de recherches politiques a publié sept ouvrages consacrés à la politique canadienne sur la concurrence (une liste de publications dans ce domaine figure à la fin du présent volume). On pourra constater que celles-ci comportent un grand nombre d'études et de commentaires, allant du fonctionnement des marchés et des initiatives législatives ou réglementaires jusqu'aux mesures de contrôle de l'exercice du pouvoir du marché, particulièrement en ce qui concerne les efforts poursuivis par le gouvernement fédéral, au cours des années 70 et 80, afin d'adapter ses politiques en matière de concurrence aux besoins d'une économie plus interdépendante et plus axée sur la technologie.

Les réformes majeures de la législation canadienne en matière de concurrence (comme par exemple celles portant sur les fusions d'entreprises et sur les abus dus à une situation dominante, qui sont maintenant inscrites dans le droit civil) ne sont pas entrées en vigueur avant 1986, quand la *Loi sur la concurrence* a remplacé la vénérable *Loi relative aux enquêtes sur les coalitions*. La nouvelle loi a eu immédiatement à faire face à la plus grande vague de fusions d'entreprises de l'histoire du Canada. Les vingtaines de fusions de grande envergure et les centaines de plus petites, venant s'ajouter à la globalisation des marchés financiers et aux efforts visant à réformer les réglementations fédérales et provinciales relatives aux institutions financières, ont suscité des inquiétudes considérables quant aux effets possibles que pouvait entraîner cette nouvelle situation. L'IRP a parrainé un colloque national, en mars 1987, dont les actes ont été publiés sous la forme d'un gros volume intitulé *Mergers, Corporate Concentration and Power in Canada*, qui a paru en 1988.

Pour marquer le centenaire de la première législation canadienne anticoalition, ou législation sur la concurrence, l'Institut, conjointement avec le Bureau de la politique sur la concurrence et avec l'Université de la Colombie-Britannique, et grâce au soutien financier de neuf cabinets juridiques importants, que nous remercions avec gratitude, a parrainé un congrès national en octobre 1989. À partir des communications présentées à ce congrès et qui avaient été commissionnées pour la circonstance, R.S. Khemani et W.T. Stanbury ont trouvé matière à la publication de deux volumes. Le présent volume et l'autre volume qui l'accompagne, *Historical Perspectives on Canadian Competition Policy*, représentent le point culminant des efforts de l'Institut en ce domaine.

Le centenaire de la législation et de la politique en matière de concurrence au Canada a fourni l'occasion de redécouvrir les origines de cet important aspect de notre politique générale, d'en analyser l'évolution, d'en évaluer les effets et de spéculer sur son avenir. Les lecteurs se rendront compte, d'après la diversité des points de vue exposés dans ces volumes, que les débats et les défis continuent pour la politique en matière de concurrence. Le rôle essentiel que jouent les forces de la concurrence dans une économie de marché oblige à réévaluer périodiquement la politique en matière de concurrence, afin de demeurer à même de la modifier en fonction des conditions économiques nouvelles.

Dans chacune de ses publications traitant de la politique en matière de concurrence, l'Institut a cherché à stimuler et à inspirer le débat public sur cette importante question, en présentant une grande diversité de points de vue. La concurrence sur le forum des idées est encore peut-être plus vitale que celle qui s'exerce sur le marché des biens, des services et des capitaux, car elle est la condition nécessaire à l'établissement de toute politique générale efficace. L'Institut espère que ces deux volumes aideront à faire la lumière sur les problèmes complexes que soulève la protection des particuliers contre les excès de l'économie de marché.

A.R. Dobell
Président

Introduction

EDITORS' OVERVIEW

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The majority of the papers contained in this volume and its companion volume, *Historical Perspectives on Canadian Competition Policy*,[1] were presented at the National Conference on the Centenary of Competition Law and Policy in Canada, held in Toronto, October 25-26, 1989 and later revised and updated. In addition, several papers on aspects of competition policy that could not be adequately covered at the conference were commissioned by the editors to be included in these volumes.

Since the passage of the first Canadian competition legislation in 1889, the legislation has evolved significantly. In response to changing political and economic conditions numerous amendments have been made.[2] In 1986, the *Combines Investigation Act* was amended, modernized and renamed the *Competition Act*. The current legislation is a general law of general application. It applies with some notable exceptions (e.g., collective bargaining activities) to all sectors of the Canadian economy, namely manufacturing, resources and services. The law touches on the everyday life of all Canadians by maintaining and encouraging competition in the market place with the objective of providing consumers with competitive prices and a variety of choices in the goods and services they buy. Competition policy is a fundamental element in the government's economic framework aimed at fostering efficiency, adaptability, innovation and growth in the Canadian economy.

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[1] See Khemani and Stanbury (1991).

[2] See Gorecki and Stanbury (1984), Stanbury (1981), Gorecki and Stanbury (1991).

1.0 ROLE OF COMPETITION POLICY AND ITS RELATIONSHIP TO OTHER ECONOMIC POLICIES

Given the fundamental nature of competition policy and its interface with a wide range of public policies and business conduct,[3] the present volume contains a diverse set of papers. Part 1 discusses the role of competition policy and its relationship to other economic policies. Boucher (Chapter 1) recognizes that while the principal objective of the *Competition Act* is to promote efficiency, there are other goals specified in S. 1.1 of the *Competition Act* which are unrelated to efficiency such as ensuring small and medium sized enterprises have an equitable opportunity to participate in the Canadian economy. Moreover, the *Act* operates in the context of many protectionist policies: tariffs, regulated industries, government-owned enterprises, occupational licensure, marketing boards and various interprovincial barriers to trade which facilitate anticompetitive practices and result in distortions in the economy. The government in this regard does not have a consistent policy towards fostering competition and efficiency. Mathewson (Chapter 2) makes a similar point.

In respect to the administration of the *Competition Act*, Boucher notes that the Bureau of Competition Policy has not generated a sufficient number of public goods in the form of orders and decisions on matters referred to the Competition Tribunal. The limits and substantive interpretations of the *Competition Act* are as yet unknown in light of the approach adopted by the Director of Investigation and Research.[4] Boucher argues that while the new legislation reflects the current state of economic thinking, the *Act* has come too late, partly because of the successful efforts of special interest groups in the political market place. The *Act* is becoming increasingly irrelevant in light of the Canada-U.S. Free Trade Agreement (which came into effect at the beginning of 1989) and the globalization of markets in general.

Mathewson (Chapter 2) discusses the tension between the political and economic objectives confronted in the area of competition policy. He suggests that it is useful to apply the public policy framework in which political parties vie for voter support in any analysis of competition in the general framework of government policies. He focusses on the anticompetitive policies of government aimed at extracting surpluses and levying taxes on corporations.

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[3] See Bureau of Competition Policy (1989).

[4] This point is also emphasized by Maule and Ross (1989) and Stanbury (1991).

The examples he cites include agricultural marketing boards, provincial constraints on competition in the brewing industry, and the practice of mandated, multi-employer collective-bargaining in the Province of Ontario. In his view, the costs imposed by government on Canadian firms renders them doomed to failure in competing in international markets.

The papers by Trebilcock (Chapter 4) and Hazledine (Chapter 5) comment further on the inter-relationship between competition and trade policies. Trebilcock argues that a liberal trade policy is an effective pro-competitive and entry-inducing force and preferable to an assertive, domestic competition policy. The two policies, in his view, are highly imperfect substitutes. Reconciling the relationship between trade and competition policies in a consistent economic framework has eluded Canada since the National Policy of 1879 and the problem remains far from being resolved today. The enactment of the competition legislation in 1889 can be tenably viewed as political fraud aimed at disguising the effects of high tariff policies.[5] Between 1952-75, for example, the Restrictive Trade Practices Commission identified anticompetitive practices being facilitated by tariffs in six cases.[6] In not one did the government follow the recommendation for reduction or removal of the prevailing customs and excise duties. Trebilcock recommends the aggressive use of the Director of Investigation and Research's power to make representations before tribunals and regulatory bodies to reduce tariff and non-tariff barriers to trade as an appropriate role of competition policy.[7]

Hazledine (Chapter 5) evaluates the theoretical and empirical evidence on the use of trade liberalization as a substitute for structural competition policy. The point is made that the findings are rather mixed. In the case of the theoretical models, the results are highly dependent on the nature of the underlying assumptions. The empirical studies also suggest a mixed picture, but do indicate that in highly concentrated industries with high levels of tariff protection, a policy of reducing either concentration or tariffs would sufficiently eradicate tendencies to raise prices above the competitive level. However, even in such situations, several qualifications need to be borne in mind. For example, competition entails more than price, but aspects of industry performance such as product variety have not been incorporated in the empirical studies reviewed. The inter-relationship between competition and trade policy is complex and requires further study than merely assuming one policy can supplant the other.

McQueen (Chapter 3) comments on some of the other implicit objectives of competition policy such as aggregate concentration and media ownership.

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[5] A comprehensive analysis of the origins can be found in Baggaley (1991).

[6] A detailed account of the weaknesses in administration and enforcement between 1889 and 1952 can be found in Gorecki and Stanbury (1991).

[7] See the discussion in Monteiro, Chapter 21 in this volume.

McQueen was closely associated with the Economic Council's (1969) *Interim Report on Competition Policy* which laid the foundations for the *Competition Act* and the amendments enacted in 1976. He believes that competition policy should be approached as an economic policy with efficiency as an overriding criteria. The administration of competition policy would otherwise be caught in a morass of balancing socio-political issues in addition to the already-complex trade-off between competition and efficiency. But the high levels of aggregate and media ownership concentration do raise a number of questions that warrant further examination regarding the framework in which our political institutions function and plurality of opinion in Canada.

2.0 CONSPIRACY

The papers in Part 2 focus on the conspiracy provisions which have long been the core of Canada's competition legislation. For most of its history, competition policy in Canada has been dominated by the enforcement of these provisions. Stanbury (Chapter 6) provides a detailed review of the record of enforcement and of the difficulties encountered in the application of the law relating to conspiracies in restraint of trade. In addition, proposals for reform are put forward. He concludes that the Canadian general public and the government have been ambivalent towards the virtues of competition and tolerant of cartels. The effectiveness of the provisions have during the past century been diluted by a number of factors such as the statutory language itself, judicial interpretation, low fines, failure to imprison executives, and inadequate enforcement infrastructure. In order to strengthen these provisions, Stanbury's recommendations include such measures as making certain types of agreements illegal *per se* (as they are in the United States), strengthening the provision for private actions, and adopting an economic approach to the offence, particularly in establishing fines.

Some of the difficulties encountered in the administration of the conspiracy provisions are due to the evidentiary requirements imposed by the criminal nature of the proceedings. The paper by Lusk (Chapter 7) reviews the kind of evidence that is appropriate to establish an anticompetitive agreement. Various cases and judicial decisions are examined as well as the effects of the *Charter of Rights and Freedoms* enacted in 1982. The rules of evidence that have developed over the years are aimed at ensuring that the convictions are based on reliable and credible evidence. The *Charter* has had a significant impact on Canadian competition legislation in this regard and will likely continue to do so.

The paper by Chipman (Chapter 8) discusses the exemption provided under the conspiracy provisions for the formation of export cartels. The amendments made to this section in 1986 requiring that the real value or volume of exports should not be lowered in order for the export cartel to be legitimate does not, in his view, provide a clear exemption. It subjects

Canadian exporters to uncertainty in face of globalization and international competition. Canada needs a policy similar to that of the United States which simply requires an export cartel does not lessen domestic competition substantially or adversely affect an exporting competitor.

3.0 MERGERS

The merger provisions represent one of the most important changes in Canadian competition law embodied in the *Competition Act* in 1986. The passage of the legislation coincided with an unprecedented wave of merger activity in Canada (Stanbury, 1988). During the past five years the major focus on the Bureau of Competition Policy has been the enforcement of these new provisions. Numerous speeches, press releases, several Information Bulletins, and most recently the *Merger Enforcement Guidelines* (March 1991) have been issued by the Director to explain the relevant provisions and the administrative policy.

The papers contained in Part 3 provide additional information and viewpoints on Canadian merger law and policy. Khemani (Chapter 9) discusses some of the structural and other features of the Canadian economy[8] which bear importantly on the design and implementation of merger policy. The extent of horizontal and vertical interdependency among firms in their pricing and output decisions increases the complexity of assessing the competitive impact of mergers in relatively small economies such as that of Canada.[9] An overly-rigid merger policy may prevent desirable, efficiency-enhancing acquisitions from taking place, whereas an overly-permissive stance would likely entrench monopolistic elements in the market. The relative economic consequences of these adverse outcomes can be high for the Canadian economy. A flexible case-by-case approach needs to be adopted, under which there is a careful weighing of the costs and benefits of particular mergers. Competition authorities must be particularly sensitive to efficiency arguments in order to facilitate structural rationalization. Where competition concerns exist, they can be mitigated by pro-active policies aimed at lowering barriers to entry and trade.

Grover and Quinn (Chapter 10) discuss the recent experience working with Canadian merger law from the point of view of legal practitioners. They also mention that since there have been no decisions from the Competition Tribunal or from the courts, the factors which surround "substantial lessening of competition" remain largely unclarified.[10] The authors are very positive about the manner in which cases have been handled by the Director and suggest practical ways in which firms can assist and expedite the merger review process. However, they point out that the Competition Tribunal has not followed the usual approach of Canadian courts in proceedings involving applications by the Director for a consent order. In all consent order applications so far concluded, the Tribunal has made suggestions that have resulted in changes being made to the consent order. They raise the question as to why would the Tribunal seek to re-examine substantive issues and alter the consent order process unless there was a manifest error. Business firms are likely to be averse to having a "second review" of merger transactions after they have satisfactorily addressed the concerns of the Director. Further, the Tribunal needs to get the Director's and the business community's confidence if it is to be an effective adjunct in the merger law enforcement process.

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[8] These are described in Khemani (1986).

[9] A comparative approach can be found in Khemani (1990).

The starting point of any merger analysis is defining the relevant market. The paper by Crampton (Chapter 11) describes the general approach towards this issue by the Bureau of Competition Policy in various cases. As Grover and Quinn have noted, there is currently a lack of Competition Tribunal decisions on this subject and the paper therefore provides useful insights into the range of evaluative criteria applied by the Bureau to delineate markets. Specific case examples are provided and the approach is in many ways akin to that adopted by the U.S. Department of Justice *1984 Merger Guidelines*.

The last paper in Part 3 is by Baldwin and Gorecki (Chapter 12) who examine the importance of firm mobility in the Canadian manufacturing sector during the 1970s. They pose the question whether turnover measures yield different information about market structure than traditional measures of concentration. Computing mobility measures based on firm entry and exit and the average shift in market shares of firms, the authors report that these measures contain a richer and more diverse set of characteristics from which to infer the competitive structure of an industry. In contrast to conventional concentration statistics, which tend to remain constant over long periods of time, the measures of firm turnover and mobility depict industries that are undergoing a substantial amount of change. These findings are in accordance with both the substance and application of the merger provisions contained in the *Competition Act*. These provisions explicitly state that the Competition Tribunal cannot find a substantial lessening of competition based solely on the evidence of increased concentration or market share resulting from a merger. In the Director's analysis of merger cases, a wide range of structural and behavioural factors are gauged including entry and exit of firms, trends in firm market shares and turnover in their size-rank (see Director of Investigation and Research, 1991).

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[10] Subsequently, the Director has made several applications to the Tribunal to challenge mergers. See *Canadian Competition Policy Record*, Vol. 12(1), 1991, pp. 1-2 (re Canada Packers); Vol. 11(4), 1990, pp. 1-2 (re Southam Inc).

It needs to be noted that in the very first three years of the *Competition Act* coming into force, a number of constitutional challenges have been raised in the courts including one against the merger provisions (see Wetston, 1991). These challenges are currently being pursued through the legal system.[11] In the meantime the Director has announced he intends to proceed as usual in bringing merger applications to the Tribunal pending final resolution of the constitutional issues. Until that time, the plaintiffs have agreed to hold separate the operations of the acquired meat rendering business.

4.0 ABUSE OF DOMINANT POSITION

Competition policy in Canada has never made simply being a monopoly an offence. It has recognized that a firm's monopoly or dominant position in the market could arise from efficiency or superior competitive performance. However, such a market position may also provide a base for engaging in business practices which limit competition substantially. The papers in Part 4 examine the abuse of dominant position provision of the *Competition Act*. Thompson (Chapter 13) discusses these provisions in light of the *NutraSweet* case - a matter referred to the Competition Tribunal by the Director. The Tribunal's decision which was in favour of the Director is currently under appeal by NutraSweet.[12] Roberts (Chapter 14) takes a historical slant to the issue of dominance. Both papers raise a number of questions/issues. The thrust of those posed by Thompson are aimed at clarifying the interpretation of the provisions contained in the *Act*. The recent decision by the Tribunal assists in this regard as will the emerging jurisprudence. Roberts, however, raises the issue of dominance in a trans-national context. He suggests incorporating the concept of extraterritoriality so that the abuse of dominant position provision in the *Competition Act* is not restricted to Canada alone. In a global environment, such a measure is required to protect Canadian consumer welfare at home and commerce abroad. In context of the *NutraSweet* case, for example, Robert's approach would require examination of the firm's position in the larger Canada-U.S. market and whether Canadian consumers are benefitting from lower prices as a result of economies of scale at the global level.

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[11] In the *Lomex-Couture/Sanimal Industries Inc.* case, involving a merger in the meat rendering business, an application was made to the Quebec Superior Court to stay the proceedings of the Competition Tribunal pending the disposition of various constitutional questions. The plaintiffs contested the constitutional validity of the *Act* as a whole, the merger provisions and also the constitution and the composition of the Competition Tribunal. On April 6, 1990 the Quebec Superior Court ruled that the *Competition Act* is constitutionally valid as a whole pursuant to the authority of Parliament of Canada. The Court held that the *Act* is in the national interest and reflects the balance of authority with respect to property and civil rights accorded to the federal and provincial legislatures. However, the merger provisions were ruled to violate the right of association guaranteed under the *Charter of Rights and Freedoms* and by the *Canadian Bill of Rights*. The contested merger was viewed as constituting an exercise of a right of association by the plaintiffs of uniting together for common business purpose. The presiding Judge also ruled that the Competition Tribunal did not possess the essential characteristics of independence and impartiality of a superior court. The selection of lay members to act as judges, the functions they exercised, their appointment and removal from office and lack of separation of powers between the executive and judicial branches were raised as deficiencies in the constitution and composition of the Tribunal. Also, an apprehension of bias could be created by the fact that members of the Tribunal retain their executive functions and others sit only part-time. See *Alex Couture v. Attorney-General of Canada* (1990), 30 C.P.R. (3d) 486.

In September, 1991, the Quebec Court of Appeal unanimously ruled that the Competition Tribunal is constitutional. This judgment also overruled the previous Quebec Superior Court judgment that the tribunal's power to block or limit mergers violated the freedom of association guarantees in the *Charter of Rights and Freedoms*. See "Quebec Court Rules in Competition Bureau's Favour," *Globe and Mail*, September 10, 1991, p. B10.

5.0 VERTICAL RESTRAINTS

Part 5 of this volume pertains to the issue of vertical restraints primarily resale price maintenance (RPM) and exclusionary contracts. The paper by Wong (Chapter 15) reviews and assesses the law on RPM since it was enacted in 1951. While this has been a relatively uncontroversial provision of the *Competition Act*, recent writings amongst a large number of economists call for a rule of reason as against a *per se* approach towards RPM and other vertical restraints. While Wong does not touch upon the current debates, it is worth noting that Canadian legislation contains limited statutory defenses for RPM, and these are discussed by Wong.

Rasmussen (Chapter 16) provides a theoretical discussion on the strategic aspects of exclusionary contracts. He points out that there may be sound and benign business reasons for certain types of these contracts.

6.0 MISLEADING ADVERTISING/DECEPTIVE MARKETING PRACTICES

The deceptive marketing practices provisions of the *Competition Act* are the subject of the papers by Addy (Chapter 17) and Neilson (Chapter 18) in Part 6 of this volume. The case law relating to these practices, namely misleading price advertising, deemed representation, double ticketing, pyramid selling, bait and switch tactics, and other such business conduct is reviewed by Addy. Neilson examines how the Director's administration of the provisions has changed with the advent of Advisory Opinions, advance consultations and information bulletins.[13] The compliance-oriented approach adopted by the Director, however, has taken place in a static legislative framework which needs to be revised. There has been a recent impetus to amend these provisions of the *Competition Act* in the direction of the policy approach adopted by the Director. These are outlined by Neilson.

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[12] See *Director of Investigation and Research v. NutraSweet Co.* (1990), 32 C.P.R. (3d) 1 and the analysis of the case by Thompson (1991).

7.0 COMPETITION POLICY AND REGULATION

The interaction between competition and regulatory policies is of considerable significance in the context of Canada's mixed enterprise system.[14] While competition legislation has been amended and strengthened over the past century, government intervention through regulatory policies and exemptions for special interest groups have induced distortions in economic performance, as the papers contained in Part 1 of this volume point out. The papers in Part 7 review in some detail the inter-relationship between competition policy and government regulation. Kaiser (Chapter 19) and Romaniuk (Chapter 20) review the jurisprudence on the "regulated conduct defence" which has been developed in the case law over several decades. The essence of this defence is that restraints of trade are exempt from the application of competition policy where the activity is authorized or compelled by validly enacted legislation. The defence is viewed by the two authors as being too broad. The court decisions have not assisted in clarifying the issue and Kaiser suggests it is time for an attempt at a statutory definition.

The paper by Monteiro (Chapter 21) provides an overview of the Director's role as an advocate of competition in his interventions in regulatory proceedings since 1976 when the legislation was amended to permit him to make such representations. The conclusion is drawn that these interventions have generally been successful in that they forced regulatory authorities to explicitly address competition concerns. An argument for increased emphasis in this area of competition policy is advanced.

8.0 COMPETITION POLICY AND INTELLECTUAL PROPERTY

An essential dimension of competition is dynamic efficiency: the process of innovation and technological change resulting in new or improved production methods, product quality and new products. In order to promote innovation, limited monopoly control over intellectual property rights are granted to firms under the *Patent Act*, the *Trade Marks Act*, the *Copyright Act*, and the *Industrial Design Act*. The rationale for conferring these rights is to provide incentives to engage in creative and inventive activity; to compensate for inherent risks and expenditures associated with innovation; to prevent expropriation and "free riding" by firms on the knowledge generated by others; and to promote disclosure of new inventions, processes and diffusion of technology so as to further technical progress.

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[13] The evolution of the misleading advertising and other deceptive practices provisions is given in Martin (1991).

[14] See Khemani (1986) and Stanbury (1989).

These objectives are complementary to those generally fostered by competition policy. However, the granting of legal monopoly control over patents, trademarks, copyrights and industrial designs have been recognized as possibly facilitating the exercise of market power, the costs of which may outweigh the social benefits of creative activity. For these reasons, remedies have been incorporated in various provisions of Canadian competition law (and intellectual property statutes) which limit the exercise of intellectual property rights.

In Part 8 of this volume, the paper by Globerman and Schwindt (Chapter 22) presents a summary discussion of the intellectual property rights legislation. The authors then examine the nature of the potential abuses of these rights from a competition policy viewpoint and whether the present safeguards are adequate or need to be strengthened. They observe that the jurisprudence in this area in Canada has been sparse (although two very recent cases raise interesting issues). This could be attributed to either the absence of a problem or to inadequate enforcement. Overall, the authors feel that abuses of intellectual property rights are not likely to be widespread. The combination of existing provisions contained in intellectual property statutes and in the *Competition Act* are sufficient to address most potential anti-competitive abuses.

In tracing the legislative developments, Anderson, Khosla and Ronayne (Chapter 23) note that the efforts to remedy or constrain the exercise of these rights have tended to vary over time. In the 1980s the pro-competitive aspects of intellectual property rights have been increasingly recognized. The current civil law provisions of the *Competition Act* dealing with abuse of dominant position replaced the previous criminal statutory monopoly provisions and provide a more appropriate basis for evaluating intellectual property rights abuses. The authors also suggest that due to the lack of case law, Canada should consider following the example of the U.S., EC and Japan by developing guidelines on the application of various provisions of the *Competition Act* to intellectual property rights. This would alleviate business uncertainty in this important area. Finally, looking forward, Anderson, Khosla and Ronayne note that the accelerating pace of technological change in the 1990s will likely pose new challenges for competition policy authorities in dealing with intellectual property.

9.0 ADMINISTRATION AND ENFORCEMENT

The papers in Part 9, the final section of this volume, provide perspectives on implementation of competition policy in recent years in Canada and abroad. Goldman (Chapter 26) discusses the approach adopted and perceived impact of the policy during his tenure as the Director of Investigation and Research. On the argument that litigation is costly to both business and the Canadian taxpayer, he has sought to maintain an "open door" and compliance-oriented policy with the use of negotiated undertakings and consent orders. This has been particularly notable in the context of enforcement of the merger provisions. However, Goldman indicates he has not hesitated to take matters to the Competition Tribunal when warranted and the overall impact of the policy has been to protect competition while balancing a diverse set of interests.

Davidson (Chapter 25), a former Senior Deputy Director of Investigation and Research before Mr. Goldman took office, is highly critical of recent enforcement efforts. He notes that, historically, there has not been much enthusiasm by the governments of the day to enforce competition legislation. He argues that the approach adopted by Goldman raises serious questions regarding the role and powers of the Director vis-a-vis the Competition Tribunal as well as the accountability and independence of the Director's office. In Davidson's view, insufficient information in the public domain through the use of compliance-oriented approach creates rather than mitigates business uncertainty.

The papers by Howe (Chapter 26) and Lane (Chapter 27) describe competition policy in the United Kingdom, primarily as it pertains to mergers and abuse of dominant position. Baxt (Chapter 28) and Stockman (Chapter 29) do likewise for Australia and Germany respectively. Rill (Chapter 30) discusses the close cooperation in antitrust enforcement between Canada and the United States. The two countries have a Memorandum of Understanding which formalizes these links, and both countries also adhere to the 1986 OECD Council Recommendations Between Member Countries on Restrictive Business Practices Affecting International Trade. In an increasingly globalized trading and investment environment, competition authorities among these and other countries have forged close links in order to facilitate exchange of views and share experiences in antitrust enforcement.

The last two papers in this volume discuss private enforcement of Canadian competition law. Strekaf (Chapter 31) provides an overview of legal developments in this area. While private parties are afforded a significant role in Canada, private actions are not likely to be as widespread as in the United States without amendments. The amendments would have to address the magnitude of recoverable damages, access to equitable relief, and use of contingency fees (see also Stanbury, Chapter 6).

Latimer (Chapter 32) reviews private antitrust law enforcement in the United States. With the exception of some modest changes, on balance he favours keeping the present system of private treble damages to compensate injured parties and to deter antitrust violations in conjunction with the government's law enforcement activities in this area.

10.0 CONCLUSIONS

The papers in this volume clearly indicate the evolutionary nature of competition policy. While the case law and administrative practice have not been static, the statutory provisions need to be modified and refined periodically in order to be relevant to the prevailing business environment, and the changing interpretations of that hard-to-define, but central concept, the public interest. Although only five years have passed since the present law came into effect, the papers contained in this volume already suggest numerous amendments and changes in administration could improve the effectiveness of competition policy in Canada. It is essential, however, that Canada's competition law and policy remain true to the central purpose specified in S.1.1 of the *Competition Act*: "to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy..."

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Chapter 1

COMPETITION POLICY AS A FRAMEWORK POLICY: SOME GENERAL ECONOMIC CONSIDERATIONS

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1.0 INTRODUCTION

The goal of a competition law is to improve the operation of competitive markets. At first glance, this premise may seem to misjudge or misinterpret the real forces at work in competitive markets. These markets do not necessarily behave like the classic ones pictured in most economic textbooks. In a world of positive transaction costs, there are many ways and means other than prices which are used by firms when competing for various potential customers. The implication here is that efficiency is considered to be an important social value. Of course, in a democratic society, it does not necessarily follow that this particular social value should be the only objective of a competition law. As a matter of fact, the Canadian *Competition Act* also promotes goals which are obviously unrelated to efficiency, such as ensuring "that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy."[1] The inclusion of this particular clause in the *Competition Act* leads to consequences and policy implications which are fundamentally different from those which would result from a law which would only promote efficiency in the economic sense. A competition law does not differ from other general policies in that it is a result of the economic forces which operate in the political market. This also appears to be the case in countries other than Canada.

In this effort to present the way in which a competition policy may serve as a framework policy, I shall focus on the three following themes: (i) the real meaning of the concept of competitive markets; (ii) the *Competition Act* as a means of enforcing economic efficiency or inducing the behavior of firms toward this ideal; and (iii) a public institution known as the Bureau of Competition Policy as a policy instrument for promoting efficiency.

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[1] See S. 1.1 of the *Competition Act*, R.S., 1985, c.C-34, as amended.

2.0 THE CONCEPT OF COMPETITIVE MARKETS

The "struggle for life" on this planet revolves around competition. In a sense, competition is the dominant social process which permeates all human activities. Competition also refers to the nature of conditions under which individuals may exchange property rights. It assumes a definition of these rights and describes a trading and production system which is consistent with the process itself. Only "the man on the spot" to use Hayek's (1945) phrase, having the specialized knowledge required to make efficient economic decisions, is able to enjoy the rewards of a profitable opportunity when the latter occurs.[2] The price mechanism, by spreading information on various changes which continuously take place in the economy, induces this agent to adjust to changing events and to decide accordingly. An efficient outcome of this process means that there are no unexploited opportunities for improvement. In Darwinian terms, the ultimate consequence of this pervasive and never-ending process is a "weeding-out" of the sluggish and the inefficient components of the system. Only the fittest firms can survive in a given industry (Alchian, 1950). Their survival is obtained and maintained by using the best available trade practices, namely those which offer reduced costs or products of improved quality to consumers. The conversion to more efficient practices can be based on the blind imitation of a successful firm, or it can be based on an informed process of learning. In the latter case, efficiency can be introduced by a trial-and-error learning process because sequential adaptations to changing market circumstances are continuously called for. Ultimately, the competitive process allows only the successful practices to thrive, even if the firms do not know how or why.

In a given market, firms are in competition with one another to satisfy consumers. However, they are also known to indulge in a bit of cooperation within a specific area in order to facilitate competition elsewhere. Because most economic arrangements such as joint ventures, partnerships and contracts entail extensive cooperation among firms who might otherwise be rivals, the key factor which enters into any decision to accept or reject them is efficiency.[3] All business arrangements which, on balance, increase efficiency, and work toward the ultimate outcome of competitive process, should therefore be considered legal.

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[2] Hayek (1945, pp. 521-522) states: "It is with respect to this [the knowledge of the particular circumstances of time and place] that practically every individual has some advantage over all others because he possesses unique information of which benefical use might be made, but of which use can be made only if the decisions depending on it are left to him or are made with his active co-operation. We need to remember only how much we have to learn in any occupation after we have completed our theoretical training, how big a part of our working life we spend learning particular jobs, and how valuable an asset in all walks of life is knowledge of people, of local conditions, and of special circumstances."

Nonetheless, based on the ease with which cooperation can evolve even among self-interested agents, the prevention of collusive business practices becomes a difficult task, especially in the light of the fact that cooperation does not require formal agreements, friendship or even face-to-face negotiations (see Axelrod, 1984). The sole requirement for a cooperative relationship, whatever the situation may be, is durability.

Thus, the competitive market, which prevails in a world of positive transaction costs, differs from the classic picture of perfect competition found in most economics textbooks. Because the market process works neither instantaneously nor with full knowledge, and because perfect price competition hardly exhausts the many ways in which profits are maximized, firms must compete on many domains, such as product quality, contractual arrangements and institutional innovation. This type of competition is multidimensional because the various sources of economic "friction" lead to two different conclusions regarding the final outcome of competition and the emergence of monopoly (Demsetz, 1974). The "self-sufficiency" theory deduces from empirical studies that the forces at work in an unregulated economy will ultimately lead to monopoly. The core of evidence is well known in the industrial organization literature: market concentration and industry profitability are positively correlated. It follows that high seller concentration facilitates collusion, while high barriers to entry protect the profits of colluding firms from erosion through new entry (Scherer, 1986). This current and mainstream view conceives of monopoly power as naturally produced by a firm or an industry because important obstacles inside and outside the industry are insurmountable. They are represented, on one hand, by market concentration as an inhibitor of competition and, on the other hand, by large capital requirements, intensive advertising, and "predatory" pricing.

The "challenging" theory sees the unregulated economy as a healthy, ongoing and adaptative process of forces converging toward efficiency, with government intervention as the prime source of monopoly power. Monopoly (or market power) is actually rare and weak because it is self-destructive. Monopoly prices eventually attract entry because actual and potential competitors can be relied upon to perform self-policing functions in investing in rent-seeking expenditures to capture part of those monopoly profits.[4] Trade practices viewed by the "self-sufficiency" theory as anti-competitive are considered, on the contrary, to be relatively unimportant sources of monopoly. They are elements of a continuum of instruments other than price which are necessary in a world where time, information, knowledge, innovation, "free riding," cheating, shirking and contracts have a price.[5]

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[3] For instance, the phenomenon of exchanges among petroleum companies has puzzled economists for a very long time. Williamson (1985, pp. 197-203) assesses the pros and cons of this practice for the Canadian petroleum industry. His own evaluation is more a Scottish verdict because there also exist procompetitive explanations for this practice.

In summary, these two views of the competitive process require totally different approaches to cope with monopoly power. Those who feel strongly that market forces increase concentration and enhance the chances of collusion among dominant firms will seek more government intervention while those holding the opposite view will seek to reduce the role of government.

3.0 THE COMPETITION ACT

3.1 Public Choice Perspective

The theory of public choice (Buchanan and Tollison, 1972, 1984) teaches that actors at work in the political market are as self-interested as all other economic agents who enter into transactions in various economic markets on a daily basis. The particularity of this market is that politicians trade public policies for votes and money in order to be elected or re-elected. A spate of studies, mainly American, dealing with a wide variety of regulatory agencies and other forms of government intervention, concludes that all of these public policies enacted over the past few decades created more negative consequences for the efficiency of the economy than benefits received by recipients. Their deadweight losses reduce the net wealth of the nation. The explanation is simple: per capita gains received are concentrated in small and well-organized pressure groups, whereas per capita losses borne by those harmed, generally "poorly" organized groups, are dispersed throughout the economy (Buchanan and Tullock, 1962). This is the conclusion of a conventional rent-seeking view of government actions, namely that government distributes wealth among various pressure groups in a manner which is markedly different from the way in wich market forces would normally operate.

Recently, a few American economists other than adherents to the Chicago School have advanced the argument that antitrust laws, as presently constituted, can be abused to reduce rather than enhance competition

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[4] This long run may be a long time coming; there may well be substantial welfare losses to society in the interim period.

[5] According to Williamson (1968), the "natural monopoly" does not even constitute a "necessary evil" because attempts to deconcentrate or to create numerous smaller firms will merely waste resources without benefiting consumers. Moreover, Demsetz (1968) argues that the competitiveness of periodic biddings on "natural monopoly" property rights would lead to price very close to per-unit production cost.

(Baumol and Ordover, 1985). Canadians are well aware of this possibility, since it took two decades to revise the present *Competition Act*. The process started in 1966, when the Economic Council of Canada was asked to study and report on Canadian competition policy. The controversy finally ended in June 1986, after many delays, a number of unsuccessful bills, and successive amendments to the *Combines Investigation Act* over the years, all of which had led to increasing skepticism in Canada (see Prichard et al, 1979).

Canadian enterprises knew very well that the *Combines Investigation Act* was difficult to enforce, for two main reasons: the use of criminal law to address the offence of "monopoly" (and mergers) required a higher standard of proof than a civil law approach, and secondly, the necessity for the Crown to prove specific "detriment to the public" apart from the elimination of competition. This was clearly established in consequence of the *B.C. Sugar*[6] and *Canadian Breweries*[7] cases in 1960 and 16 years later in the *K.C. Irving*[8] (1976) case by the Supreme Court of Canada (see Reschenthaler and Stanbury, 1977). Any change of this situation was generally opposed by existing firms because it would increase uncertainty. Of course, politicians are well known for their reticence to take unnecessary risks when they perceive their electoral fate is at stake. Because they value stability for its own sake, the tyranny of the *status quo* has continued to prevail as long as pressure groups which benefit from economic rents are better organized politically than groups which are harmed (Becker, 1983).

3.2 Conflicting Signals

However, the present version of the *Competition Act*, along with the old one, operates in a peculiar context which has many protectionist characteristics such as: tariffs since the National Policy of 1879, regulated industries, publicly-owned enterprises, occupational licensure, marketing boards, and interprovincial non-tariff barriers. This wide-ranging variety of government intervention creates distortions which may foster anti-competitive practices and ultimately make it easier for firms to collude. The following two cases will illustrate the devastating consequences that those artificial government-induced distortions have on the efficiency of the economy. A by-product of *Canadian Breweries* (1960) case[9] is that prices, when fixed by provincial authorities,

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[6] (1960) 129 C.C.C. 7 (Man. Q.B.).

[7] [1960] O.R. 601 (H.C.J.).

[8] (1976) 32 C.C.C. 1 (S.C.C.).

[9] In that decision ([1960] O.R. 601), McRuer J. stated the so called "regulated conduct defence" in the following terms: "When a provincial legislature has conferred on a commission or board the power to regulate an industry and fix prices, and the power has been exercised, the Court must assume that the power is exercised in the public interest." In 1982, the Supreme Court of Canada confirmed the validity of the regulated conduct defence in the *Jabour* case (*A.G.*

cannot be at an anticompetitive level because such regulation is deemed to protect the public interest. In other words, service industries which were provincially regulated were at least partially exempted from the competition law. The second case refers to *Allied Van Lines Limited et al.* (1983).[10] As in all other segments of the trucking industry, this provincially regulated household-goods moving industry set up a tariff bureau whose role was to jointly set rates and tariffs for its members. Prices to move household goods were fixed at levels higher than marginal costs as was the case in all tariff bureaus in North America under such a regulatory regime. But these specialized trucking firms went one step further: they also traded information on a continuous basis in order to control their respective share of the market. They even used provincial regulatory agencies to monitor and discipline "cheating" firms which cut their prices to expand their output. In other words, regulation, by lessening competition, facilitated the creation of a cartel and thereby reduced the cost for colluders.

Many signals are sent to Canadian firms and efficiency is only one of them; the central problem is that there are conflicting signals. As a matter of fact, some trade practices may be exempted from the competition law because the government protects a particular industry, whereas the same practices will be considered anti-competitive in another industry. If the main objective of a competition law truly consists of perfecting the operation of competitive markets, its role, therefore, is to eliminate deleterious practices and penalize market power acquired by collusion, the major source of market power (see the paper by Stanbury in Part 2 of this volume).

Moreover, paraphrasing Adam Smith's dictum, the fact that the level of competition is limited by the extent of the market has two consequences on the application of a competition law. First of all, local monopolies will generally be neglected or will never be attacked because the injury caused to the society is weak, the volumes of sales considered being unimportant and the possible anticompetitive violation being relatively minor (Landes and Posner, 1981). Market forces will eventually police them if there is an opportunity to increase wealth. All other solutions will be more costly to the society than the benefits obtained by a suit. The second point is deduced from a conclusion drawn from Axelrod's research on how cooperation evolves among self-interested agents when interactions are frequent and durable. If cooperation without formal agreements is easily attainable, then "antitrust activities should pay more attention to preventing the conditions that foster collusion than to

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of Canada et al. v. Law Society of British Columbia, (1982) 2 S.C.R., 107). See Stanbury (1984).

[10] *R. v. Allied Van Lines Limited et al.* (1983) Supreme Court of Ontario, December 14, 1983, unreported decision.

searching for secret meetings among executives of competing firms" (Axelrod, 1984, p. 180).[11]

Finally, it should be noted that the use of the Competition Tribunal also has an opportunity cost which may be substantial in some circumstances. If a beneficial trade practice is condemned by the Tribunal, the benefits generated will be lost forever because no other firm will use an unlawful practice fearing to be penalized in the name of the legal precedent or *stare decisis* (Easterbrook, 1984). On the other hand, if the Tribunal authorizes an anticompetitive practice, its deadweight cost will decrease over time as quickly as firms adapt it. Market forces will rapidly correct the latter whereas the former will never be corrected, unless higher courts reconsider their initial decisions or unless Parliament changes the law. In this case, the Bureau of Competition Policy must therefore proceed with new cases.

4.0 THE BUREAU OF COMPETITION POLICY AS AN INSTITUTION

Posner (1974) and Becker (1983) emphasize that economic institutions which are controlled by government tend to be efficiency enhancing in their domain as private economic institutions are in their respective market. In other words, all public institution can be expected to operate with reasonable efficiency to achieve their ends, because forces operating in the political market have designed it accordingly. The reason, of course, is that inefficient institutions have left potential rents uncollected. As nature abhors a vacuum, politicians also abhor wasted resources which, if used to achieve their respective ends, would increase their probability of re-election. In other words, utility-maximizing politicians equalize their usual marginal conditions, expressed in terms of votes, to the marginal conditions for optimizing opposing groups when investing in rent-seeking activities. Competition is an ever-present factor.

The Bureau of Competition Policy is the major input in the production of cases to be presented to the Competition Tribunal. In so doing, it produces a collective good,[12] which is law enforcement. Moreover, this institution also helps to create law, another pure public good. The new Canadian law on competition introduces some interesting changes, notably with respect to mergers and abuse of dominant position. The information on these two matters which is actually spread throughout the economy comes from the legal precedents of the *Combines Investigation Act*. In other words, the jurisprudence created by judicial decisions in prior periods still constitutes the general norm or standard which can be used to guide behavior of a firm in these matters, as long as new cases are not brought before the Tribunal. Decisions by the Tribunal will send out strong signals regarding the kinds of practices that will be judged as competitive or not. In this sense, the Bureau of Competition Policy, considered as a public institution, creates a public good. Its output, the production of cases to be adjudicated, will induce the Tribunal to gradually create new legal precedents or validate the former ones. Those decisions will generate a new situation and firms are expected to adapt accordingly, either by changing their actual trade practices or by maintaining their old ones.

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[11] For assessments of the Bureau of Competition Policy's enforcement policy, see Shorthill and Jones (1990), Stanbury (1991), and Maule and Ross (1989).

[12] A collective good is traditionally defined by its two properties, namely the joint consumption or nonrivalness in consumption by several individuals and by the fact that users may not be excluded from access to the product (Samuelson, 1954).

However, to date, the Bureau of Competition Policy has not actually contributed to the production of new public goods, namely decisions (orders) made by the Tribunal in conformity with the new law. The Tribunal has been given very few opportunities to define the specific requirements of the *Competition Act* in the circumstances presented by a case and eventually create (if repeated in a long line of decisions) a specific rule of legal obligation applicable to like circumstances. Most merger cases handled by the Bureau of Competition Policy have been settled by mutual agreement between the parties and the Director.[13] This program of compliance, as it is known, also provides few details on the facts of the cases and the terms of the settlement. As cases are resolved out of the court-room, no legal precedent is thus created that could guide the decision making of others.

This case-by-case approach implies that no one really knows the content and the limits of the *Competition Act*. No general and impersonal information, in the form of published decisions by the Tribunal, is produced which would possibly help firms to avoid running afoul of the law. This is the opportunity cost of the policy preferred by the Bureau of Competition Policy. The latter has made a clear choice between reducing the cost of administering the competition policy through private negotiations between the parties and the cost of producing public information which will help Canadian firms to form expectations regarding the legal aspect of their trade practices. In order to better understand the consequence of this choice, let us examine an argument developed by Easterbrook (1984, p. 6). He argues that a host of business practices, like tie-ins, resale price maintenance, vertical territorial and customer restrictions, patent pools, and block-booking, which had been condemned should be reconsidered, now that pro-competitive explanations for these practices have been developed. Because no firm is anxious to be the first one before the Tribunal, and because each firm has the opportunity to negotiate, the Tribunal may never be asked to resolve their validity in the framework of the *Competition Act*.

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[13] See Maule and Ross (1989) and Stanbury (1991).

5.0 CONCLUDING REMARKS

The *Competition Act* takes advantage of much of the so- called new learning in the field of industrial organization economics. It is therefore a big step in that the opportunity is now given to cast doubts on some former Supreme Court of Canada decisions which were analytically unsound from an economic point of view. The *Competition Act* is an instrument which can effectively tackle the various dimensions of competitive markets in a world of positive transaction costs.

On the other hand, the "marvel" of the economic system is that prices serve as signals inducing economic agents to continuously adjust to new changes. It must also be expected that the competition law which determines how competitive markets must function to achieve efficiency should embody some of the same characteristics. I refer to the importance of decisions (including consent orders) as a reliable predictor. Decisions by the Competition Tribunal will thus give firms legal information regarding the validity of their trade practices and will reveal the implicit price to be borne if a particular practice is declared unlawful. This impersonal aspect of the competition policy is not in operation yet, mainly because the Tribunal has been supplied with few cases to be examinded. There should be a counterpart to the price mechanism in competition policy, namely published decisions,[14] so that the "invisible hand" of the Tribunal should adjudicate in open and impersonal manner.

Finally, the *Competition Act* comes too late because the Free Trade Agreement and some GATT rulings against Canadian practices, among other factors, will surely increase the level of competition prevailing in Canada, which is after all, a small, open economy. This more competitive framework will make it more difficult for Canadian firms to set anticompetitive practices, because a greater number of substitutes will become available to consumers as well as to producers.[15] This result is a straightforward consequence of a first principle of international trade theory, namely that small economies do not have the power to influence prices in a world market. As a further consequence, the burden of inefficient policies is mostly borne by members of small economies. Competition law in Canada, therefore, has become more and more irrelevant.

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[14] In the case of the abuse of dominant position provisions, see the Tribunal's decision in *NutraSweet* (1990) 32 C.P.R. (3d) 1.

[15] See the discussion by Trebilcock in Part 1 of this volume.

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Chapter 2

COMPETITION POLICY IN THE MENU OF GOVERNMENT ACTIONS

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1.0 INTRODUCTION

It is tempting to argue that the purpose of competition policy in both design and execution in Canada is to improve the allocation of resources. That is, competition policy, perhaps along with other government policies, seeks to maximize the wealth of Canadians. For those economists involved in the process itself, either with the Crown or the private parties under scrutiny by the Crown, wealth maximization is a useful working hypothesis to frame analyses and arguments presented either to the Bureau of Competition Policy officials or to the Competition Tribunal or the courts in general.

But government policy in general has never sought to pursue such goals, and therefore, it is a mistake to attempt to interpret competition policy within this structure. I will argue that a more productive approach for understanding government policy in general, and therefore competition policy in particular, is the public choice framework in which political parties are seen to vie for voter favor in a political marketplace. Thus, for example, historically at least, competition policy was part of the general policy earlier this century to protect Canadian industry from foreign competition; or competition policy takes a back seat when it comes to government policies toward agriculture or unions in Canada. These other policies exist to protect special interest groups from competition, whether they be elements of Canadian business or labour. Furthermore, as George Stigler (1971) points out, these policies do not simply transfer wealth between groups in society, they result in a net reduction in total wealth. That is, while these policies transfer benefits towards certain politically acceptable groups, the cost of these policies exceeds the benefits received. An appreciation of this general message requires an understanding of the nature of the political marketplace.

2.0 POLITICAL MARKETPLACE

This marketplace is unlike other conventional economic marketplaces, i.e., those for goods and services. Competition policy is one of the policy instruments available to political parties to achieve their objectives, objectives that are designed to keep them in office. Arguing that economic efficiency is the sole objective of competition policy would be sensible only if competition policy and all other government policy instruments were completely separable in their impact on each other and on the pursuit of governmental objectives. Politicians seek initial and subsequent election and individuals and interest groups support policies and parties that increase their individual net wealth. In particular, as Stigler (1971) points out, the state has the non-conventional coercive power of taxation and interest groups seek favors, subsidies, through the state, financed by the taxing power of the public authority. The problem with bestowing such subsidies on certain groups in society is that with mobile resources, super-competitive rates of return in one endeavour will encourage others to migrate to that field, dissipating the rents. These general ideas have been refined, extended and tested by an impressive set of economic scholars that includes Gary Becker (1983), Harold Demsetz (1982) and Sam Peltzman (1976) among others.

In his private interest theory of regulation, Stigler (1971) predicts the attributes of those groups in society that will succeed in currying the favour of the public sector. The more concentrated the recipients of the benefits, the more politically important their vote, and the more dispersed the cost of the subsidies among other members of society, the more likely any single interest group will succeed.

What is the connection between all of this and competition policy? The answer is that the implementation of the political agenda for a vote-maximizing political party is independent of any existing competition policy. Or the competition policy adopted by any political regime is likely to reflect the implicit restraints imposed on politicians to carry out their political platform. I am not suggesting that each time a new party gains an electoral victory it will immediately seek to alter formally any competition legislation to implement its set of subsidies and taxes. Competition policy is not that important in implementing any political agenda. I do believe, however, that in framing competition policy, say in drafting the legislation, political parties will seek a degree of flexibility that will ease a subsequent political agenda and that, in general, political parties may (likely will) implement platforms and regimes that are anticompetitive.

3.0 EXAMPLES

Some examples will serve to illustrate my point.

3.1 Agriculture

Political parties in Canada have long favored subsidies to the agricultural sector.[1] One form of these subsidies is the existing marketing board arrangements with quotas on supply (milk, chickens, turkeys, eggs).[2] Consider those products with tradeable quotas. Restricting supply through government mandate creates monopoly power. When supply is restricted, price increases above levels of marginal cost and rents are bestowed on those who own the quota. This is clearly an anti-competitive policy. There are clear losses associated with the foregone consumption from those consumers who would willingly pay the price required to cover the cost of the farm resources used to produce additional output. Furthermore, agriculture interest groups lobby to secure these benefits in the first place. Both of these represent economic losses to society. Such politically-motivated government interventions to bestow benefits to agriculture are anticompetitive. Indeed, they lessen competition substantially. Yet, it is highly likely that any competitive challenge to their existence (say by the Bureau of Competition Policy) would be not only politically unpopular but doomed to failure on legal grounds as well.[3]

Successful challenges to this quota system are likely to harm current holders of the quota as opposed to those who received the initial windfall gain. This is true to the extent that quota are tradable and there has been active trading in the quota. Quota values reflect the expected discounted value of the profits to be gained from holding the quota. Not only can there be uncertainty associated with the profits from using the quota for agriculture production, but should the government issue additional quota or do away with the quota system altogether the present holders will suffer a loss. These holders will spend up to their anticipated losses to fight against any losses. This represents an additional reduction to wealth. So there are forces at work that will oppose changes in this system, changes that have the potential to be wealth enhancing. Furthermore, with the current distribution of the gains and costs of agricultural quota, the nature of competition in the political marketplace makes any change in the quota system unlikely even though wealth in Canada may increase as a result. This is political reality.

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[1] A *Globe and Mail* editorial (October 3, 1990) noted that in 1989 government assistance of various types (over $8.8 billion) accounted for 68% of Canadian net farm income, up from 30% in 1980. On average, each farmer received $15,000 in federal and provincial money. See also Terence Corcoran, "Farmers' safety nets hard on taxpayers," *Globe and Mail*, December 11, 1990, p. B8; Madelaine Drohan, "Farm supports laid ou, Annual programs worth $8.8 billion," *Globe and Mail*, October 3, 1990, p. B1; Grant Reuber, "Farm Subsidies raise food prices, fuel inefficiency," *Globe and Mail*, November 19, 1990, p. B8.

[2] See Janigan (1990) and Simpson (1990) re chickens and milk respectively.

[3] See the discussion of the *Jabour* case ([1982] 2 S.C.R. 307) in Stanbury (1984).

Agricultural producers without quotas will also engage in actions to acquire such marketing board power. Recently, forces within the Canadian potato farming community attempted to secure such benefits through the implementation of a marketing board with powers to limit supply. To give credit to the Bureau of Competition Policy, it opposed the formation of such a board.

3.2 Jurisdictional Competition: the Case of Beer

In January 1989, Molson and Carling O'Keefe announced their intention to merge their brewing operations.[4] Beer production and distribution in Canada is an industry replete with government regulation of one form or another (mostly provincial government regulation) and, as of 1989, exempted from the Canada/U.S. Free Trade Agreement. There are interprovincial restrictions on the importation of beer, not only from other countries but from other provinces. Beer drinkers in Ontario will be familiar with the distribution and pricing policies of the Brewers Retail system, a government-sanctioned distribution network in Ontario owned jointly by the breweries. Viewed from the structuralist perspective on market concentration, it would be easy, within the context of brand name entry requirements on a national level and the production, ricing and distributional policies of provincial governments within Canada, to be concerned over the competitive effects as two of three major brewers in the country merged. Many observers expressed such a concern. But within the context of the political marketplace, such a concern was misplaced. There is ample evidence of significant economies of scale and scope in the worldwide production and distribution of beer (see Irvine et al., 1989). The large grow larger and more efficient. As the costs of import protection grows, there is and will be increased pressure to permit the importation into Canada of foreign produced goods on more favorable grounds. While local distribution policies restrict price competition to varying degrees in Canada, there was unlimited non-price competition through advertising and promotions that dissipated all the gains from the more limited domestic competition. Increased costs of local protection to both consumers and more efficient local producers enhance the push for deregulation of the domestic beer industry.

Two points are salient here. First, the existing system of production and distribution imposes significant impediments to competition through price and imposes significant barriers to the importation of foreign product viewed from both a national and a provincial perspective. Its competition aspects not withstanding, this arrangement had political survival value as it had been in place for many years. Domestic producers, local unions and respective provincial governments had been the beneficiaries (not to mention temperance groups). Second, as the costs of this economically inefficient regulation rise, a politically-imposed system of restricted local production should soon be replaced by a more open system of international competition. To compete against the large producers of the world, local producers would have to be equally efficient or not survive. Therefore, seen within this forward looking structure of political competition, the merger could be understood as procompetitive.

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[4] "Molson deal creates $1.5 B superbrewery," *Financial Post*, January 19, 1989, pp. 1, 4, 5. The merger was not challenged. The resolution of the case is described in the Bureau of Competition Policy's press release "Proposed merger of the brewing operations of Molson and Carling O'Keefe," July 6, 1989.

3.3 Mandated Multi-Employer Bargaining in the Construction Industry

Beginning in 1977, certain sections of the construction industry in Ontario (the industrial, commercial and institutional section of the construction industry) were governed by a mandated scheme of province-wide bargaining. This scheme set a province-wide set of wage rates for unions in the construction industry. The change to this province-wide arrangement was favoured by both unions and by the corresponding construction/employer association in Toronto. Such a scheme is anticompetitive and yet it was implemented by explicit provincial government policy. First, consider its anticompetitive nature. The setting of province-wide wage rates discourages firms from out of the region from bidding on any large construction project within a given region. Prior to this legislation, firms from outside (say) Toronto who may face lower costs were permitted to bid on construction projects in Toronto and then to supplement their own local union personnel with nonunion personnel from Toronto. This meant that in some cases firms from Ottawa could bid successfully on construction projects in Toronto. With province-wide rates and the removal of the option to use local non-union personnel, the competition from out-of-region firms would be reduced. This would reduce the competition faced by local firms. But more importantly, given the powers of unions to assign and control their personnel, this reduction in competition with any increase in monopoly rent accruing initially to construction firms could be extracted ultimately by unions through their wage and employment policies.

This apparently anticompetitive policy was adopted by the Government of Ontario. I suggest that this policy had a political objective with an anticompetitive result. The policy reduced the mobility of resources within this industry and offered a barrier to entry protecting local firms from competition from firms outside their region. The beneficiaries were large construction firms in Toronto and other urban areas and union members. I have no doubt that these actions had some political survival value for the party that was then the Government of Ontario.

4.0 CONCLUSION

My principal conclusion is that if the objective is to understand competition policy and its objectives at the design stage, a understanding of the political marketplace is essential. A useful working hypothesis for the implementation of a particular section of the *Competition Act* from the perspective of lawyers and economists is that the Act promotes the efficiency of resource allocation in Canada.[5] This will get investigators a considerable distance in analyzing the competitive consequence of particular policies of firms being scrutinized under the Act. This takes the Act as a given and views the Act in isolation. This also takes the case as a given. One important and politically sensitive discretionary power of the Bureau is to select the cases that it pursues (see Shorthill and Jones, 1990). Under the merger sections of the Act, this discretionary power is limited as the Act mandates minimum sizes for filing requirements. Still, there is discretionary power over which mergers and which features of these mergers need to be challenged. I suggest that this discretionary power is greater with respect to other market practices.

The deeper and more "academic" question of what motivates competition policy and what are its realistic goals requires the integration of competition policy into the general menu of government action. In this context, economic efficiency in some narrow sense is not the appropriate criterion. If political actions are included in the general set of economic activity, then government policies are efficient in the sense that parties compete with one another.

There is an important sense in which international trade and open markets limits the ability of politicians to levy taxes and benefits. If particular government policies impose costs on firms that render them non-competitive, and these firms sell their goods in an open world market, such firms are doomed to fail. It is difficult (impossible) for governments to squeeze rents from world consumers through domestic firms where international competition will eliminate the resulting inefficient firms. This tension between political objectives and economic competition is further developed in the paper on trade and competition by Michael Trebilcock in Part 1 of this volume. The more general goals of competition policy in the context of the evolution of U.S. antitrust policy have been set out in Baxter (1979), Stigler (1985) and Telser (1982).

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[5] Generally, see S. 1.1 which begins with the following words: "The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy..."

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Chapter 3

ON SOME OTHER OBJECTIVES OF COMPETITION POLICY

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1.0 INTRODUCTION

I planned these comments on the assumption that others would do a good job of fitting competition policy into the framework of economic policy and its typical objectives, especially those of economic efficiency: allocative, technical and very-long-term, dynamic efficiency. Unlike some assumptions by economists, that one held up pretty well.

What I did not anticipate was that there was going to be such a celebration of public choice theory. Had I known that, I might have been tempted to join the party in a larger way, citing some of my own favourite works on public choice, such as Lindblom's *Politics and Markets* (1977), and Okun's *Equality and Efficiency* (1975).

Something that does have to be remembered in all this explosion of public choice is that, however strange and unlovely are the conflicting pressures that motivate government policy-making in areas such as competition policy, towards the end of the day the government must produce something at least minimally plausible. It must provide, for example, some instructions to the Competition Tribunal that will pass muster with the general public, and not be a complete logical morass.[1]

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[1] Note that in the merger provisions the Tribunal is given no guide as to how to make the trade-off between the lessening of competition and efficiency gains. Section 96 of the *Competition Act* simply states that the Tribunal "shall not make an order" against a merger which "has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger..." The trade-off is addressed in the Director of Investigation and Research's (1991, Part 5) *Merger Enforcement Guidelines*.

2.0 AGGREGATE CONCENTRATION

Leaving the mainstream economic objectives to others, I focus on some of what Gorecki and Stanbury (1984, Ch. 5) call the "lesser objectives" of competition policy.[2] I am particularly interested in those located in the borderland between economics and politics, and centering on issues of economic control over the democratic political process. They arise, notably, in relation to the numbers of aggregate (as contrasted with market) concentration.[3] Amongst industrial countries, we in Canada seem to have one of the highest rates of aggregate concentration (see Marfels, 1988).

Economists have often looked at aggregate concentration, and at the diversifying and conglomerate mergers which partly feed it, and have rarely found very much economically wrong with any of them, at least from a competition policy standpoint.[4] (There may be other things economically wrong with some of those mergers; Wall Street is currently reflecting on that.) Yet it appears that many economists entertain some generalized uneasiness about those aggregate concentration figures. For example, in 1984, the largest 100 Canadian non-financial enterprises held 52% of non-financial assets (Khemani, 1988, p. 28).

Perhaps economists are not too worried by that figure. But suppose, hypothetically, that the number were to rise to 62%, or to 72%? Or to the point where largest 50 enterprises held three-quarters of assets? Are you still not worried? Not even enough to want to know what economic forces might lie behind the movement?

A similar experiment may be conducted in terms of corporate assets controlled by the six or seven most asset-heavy business families in Canada. McKinley (1985, p. 4) shows that nine family-controlled conglomerates accounted for 26% of the quoted value of shares in the TSE 300 (28% if the five largest banks are removed). The nine conglomerates account for 21% of all Canadian-based companies listed on the TSE. Niosi (1988, p. 45) shows that the 35 largest conglomerates in Canada increased their share of sales in the total economy from 7% to 10% between 1969 and 1984 and their share of assets from 11% to 14%. Khemani (1988, p. 28) shows that the share of assets held by the 100 largest non-financial enterprises increased from 38.6% in 1965 to 52.1% in 1984. The share of the top 25 increased from 23.8% to 35.3% over the same period. Further, Khemani (1988, p. 26) shows that 15 economy-wide conglomerates' share of all corporate sector assets increased from 6.8% to 16.0% between 1977 and 1985. The merger boom in the late 1980s no doubt increased aggregate concentration further.[5]

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[2] These "lesser objectives" are declaring the common law, fighting inflation, protecting small business, preserving the free enterprise system, preventing the concentration of economic power, ensuring fairness and honesty in the marketplace and competition policy as political compromise. The three main objectives of Canadian competition policy identified by Gorecki and Stanbury (1984) have been preventing abuses of economic power, maintaining free competition, and achieving economic efficiency.

[3] Khemani (1988) does a good job of drawing the distinctions among the various types of measures of concentration.

[4] But see Adams and Brock (1986).

Twenty years ago, I was associated with the Economic Council's *Interim Report on Competition Policy* (1969), which took the stand that competition policy should be approached as economic policy -- period. That was probably a useful approach to sorting out the weak, messy, unbalanced condition that competition policy found itself in at that time. In any case, it was the only approach likely to have proven acceptable (and then only barely!) to the Council. And it is still the approach that I think the Competition Tribunal should take in the adjudication of cases referred to it. The Tribunal has enough to do offsetting competitive against efficiency effects, and juggling and sometimes offsetting three different and not always compatible kinds of economic efficiency, without also having to take into account cloudier political-economy issues.

3.0 FRAMEWORK OF POLITICAL INSTITUTIONS

Yet, upon 20 years' reflection,[6] it seems to me that those issues remain with us, as they have from the beginning, compelling us to recognize that part of the framework to which competition policy relates is really the framework of political institutions, and of how we resolve recurring conflicts between those two great systems of governance: one-dollar-one-vote and one-person-one-vote. We already have one specific link here in the form of the Director of Investigation and Research's important responsibilities in respect of directly regulated industries.[7]

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[5] Diane Francis (*Financial Post*, April 9, 1990, p. 2) reports that a recent study by Statistics Canada found that the Peter Bronfman group of companies control some 360 companies each with at least $10 million in assets. The group's 10 largest non-financial entities had $42 billion in revenues. Its four largest financial entities control $47 billion in assets. Other major groups are Canadian Pacific Ltd., BCE Inc., the Weston family, Charles Bronfman trusts, the Irving family. Francis noted that in 1986 20 of Canada's 100 largest public companies were publicly held. In early 1990 the number was down to 12. They control 23% of the $345 billion assets of the 100 largest corporations.

[6] This includes the work of the Royal Commission on Corporate Concentration (1978) and the useful critique of its handling of aggregate concentration by Gorecki (1979).

[7] See, for example, the Director's *Annual Report* for 1987/88, pp. 25-28 and for 1988/89, pp. 31-34 and the paper by Monteiro in Part 7 of this volume and *Canadian Competition Policy Record*, Vol. 8(4), 1987, pp. 2-3.

Democracy and market capitalism go well together in some ways, but not in others. To be sure, glasnost seems in many cases to be a necessary precondition, if not a sufficient one, for the success of perestroika. But we can also expect some persisting conflict arising from the tendency for those with many dollars to favour the one-dollar-one-vote system, while those with little more than their persons and ballot papers lean the other way.

Democracy seems to promise participation in the working out of conditions affecting one's destiny. Market capitalism, especially when its verdicts are rendered from the Torontos of this world -- faraway power centres -- seems to overrule that participation. Such overruling becomes much more specific and resented when it appears to reflect the ability of corporate size to bend the political rules of the economic game. A troubled fish plant with 14 employees may face early bankruptcy. A plant with 400 employees may seek instead to bend the fish inspection rules and so become the focus of a tuna scandal (see Hoy, 1987, pp. 320-327).

Let us note, too, that corporate size in terms of jobs confers more power in a 7% unemployment economy than in a 4% one -- and more still, of course, in a 12% unemployment regional economy. The relative downgrading of high employment as a macroeconomic objective of the federal government has not caused the issue to disappear. Rather, it has emerged all the more strongly as a micro issue, with every particular government contract and tax adjustment being scanned by the media and justified by government in terms of how many jobs it is forecast to create. This does not improve the longer-term efficiency of micro decision-making. What it does do, however, is increase the political leverage of firms in a position to grant, maintain, withhold or withdraw jobs in the hundreds and thousands. Where, for example, there is a choice of locations for a big new plant, and different political jurisdictions are scrambling for the prize, it would, frankly, be unfair to the shareholders for the company not to do some playing off and bargaining for concessions.

4.0 CANADIAN POPULISM?

Do Canadians care? Stanbury (1988), and Gorecki and Stanbury (1984), claim that we have no populist tradition in Canada. I think they overdo this. We have, certainly, less of a populist tradition than does the United States. But has a country which vaulted to political prominence such figures as Tommy Douglas and John Diefenbaker (and I guess I would have to add William Aberhart and Real Caouette) no populist tradition? What about Diane Francis (1986) book?

Here is a classic expression of populism from the United States:

> Local economic independence cannot be preserved in the face of consolidations such as we have had during the past few years. The control of American business is steadily being transferred, I am sorry to have to say, from local communities to a few large cities in which the central managers decide the policies and the fate of the

> far-flung enterprises they control. Millions of people depend helplessly on their judgment. Through monopolistic mergers the people are losing their power to direct their own economic welfare. When they lose the power to direct their economic welfare they also lose the means to direct their political future ....[8]

Now, does this not find some echoes -- especially regional echoes -- in Canada? Does it not embody what the East and West of Canada have felt for generations about economic control from the Centre? Going to the municipal level of government, where the more dubious interactions of one-dollar-one-vote and one-person-one-vote stand out more crudely, can Canadians be said to be wholly unconcerned about the influence often exerted by large property developers upon municipal councils? Their periodic election of reform slates indicates some concern, although how durable the results of this tend to be is another question. Finally, in a poll cited by Khemani, Shapiro and Stanbury (1988, p. 10), of respondents expressing some degree of concern with corporate concentration (81%, including a lowest tranche of 22% "not very concerned"), almost as many were concerned about the political power and influence of large corporations, as about their prices and competitive strategies.

In short, issues relating to aggregate concentration do seem to be alive in Canada, and not just in the minds of academic political economists. What should be done about them? What should not be done, in my opinion, is to try to convert this area of concern into case law under the *Competition Act*. We are not ready for that and may never be. And competition policy has never boiled down entirely to case law, nor should it.

What we need at present is to better inform our concern in this area. Why is aggregate concentration so high in Canada? Are there sound, pro-efficiency, economic reasons for it? Is it, for example, mainly a matter of reorganizing industry into larger units needed to meet heightened international competition? That thesis has, of course, been propounded; but does it stand up? We should know.

This is not a matter for the Tribunal. It is a matter for a watching brief, and for periodic general enquiry and report, under the aegis, I would suppose, of the Director of Investigation and Research. I was very sorry to see general enquiry dropped from the *Act* in the 1986 legislation. Some published enquiries were no doubt better than others; but on the whole, enquiries contributed much to the policy, and could do so again. They should be restored in some new guise.

When we are better informed, we may be able to discern courses of action to strengthen the integrity of our political system without untoward sacrifice of economic efficiency.

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[8] Senator Estes Kefauver, 1949, cited by Gorecki and Stanbury (1984, pp. 131-132).

5.0 OWNERSHIP OF THE MEDIA

One area which particularly concerns me is that of the media, where ownership has lately grown very concentrated. It is a pity that the *Report* of the Royal Commission on Newspapers (1981) did not receive more prolonged and thoughtful consideration, but was, so to speak, drowned out in a chorus of "Freedom of the Press", sung by a rare mixed choir of journalists and publishers.[9]

Interestingly, an article in the London *Economist*, a journal probably to be trusted not to desire state censorship in any shape or form, took up the matter of concentrated media ownership, recommending as follows:

> The media have moved beyond being mere providers of entertainment and information. They have become a forum that rivals parliaments. A plurality of opinion in that forum is as essential to democracy as the ballot box. The market will provide a plurality of views only if there are enough channels or newspapers to choose from (which, in most countries outside America, there are not). In the case of television, the financial barriers to entry are still too big for new channels to spring up overnight. So how can a regulator keep the forum open to variety?
>
> The worst solution is subjective interference. A government-enforced plurality of opinion -- rules that there must be three left-wing newspapers where there are three right-wing ones -- would quickly become an Orwellian nightmare. The best, light-touch way to protect pluralism would be to limit owners to a particular portion (say 25%) of any particular "news" market" -- be it television, radio or newspapers ... (*The Economist*, 1988).

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[9] Moreover, the Mulroney Government in June 1985 revoked a 1982 Order in Council requiring the CRTC to refuse broadcasting licenses for stations owned by newspaper companies. In 1983 the CRTC had ruled that a TV license owned by the Irving family in New Brunswick was ineligible for renewal because of cross-ownership. It had given the owners until January 1, 1986 "to rearrange their affairs or for other arrangements to be made." Hence, the Irving interests, with net assets of some $8 billion, was not required to divest one of its TV stations. See *Canadian Competition Policy Record*, Vol. 6(3), 1985, pp. 45-46.

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Chapter 4

COMPETITION POLICY, TRADE POLICY, AND THE PROBLEM OF SECOND-BEST

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1.0 INTRODUCTION

In specifying a role for competition policy amongst a government's other macroeconomic and microeconomic framework, policies, I argue that by far the most important relationship is that between competition policy and trade policy. Further, rationalizing this relationship in an economically coherent and consistent way has bedeviled competition policy from its inception and remains far from resolved at the present day. More specifically, I argue that a liberal trade policy is a far more potent pro-competition, entry-inducing, force than domestic competition or antitrust laws in most industries and that espousing strongly protectionist trade policies simultaneously with assertive domestic competition policies, or assertive domestic competition policies simultaneously with liberal trade policies plunges us deep into a second-best world where welfare judgments about particular competition policies or their application in particular cases often become highly problematic. In other words, a liberal trade policy and an assertive competition policy are highly imperfect substitutes. A liberal trade policy and a sensitively designed and applied competition policy may be productive complements and would seem the optimal pro-competitive mix of policies, specially for a small, relatively open economy, such as Canada's. I would rank the possible mixes of international trade and domestic competition policies from a pro-competitive, efficiency-oriented perspective as follows:

		Trade Policy	
		Liberal	Protectionist
Competition Policy	Restrained	1	4
	Assertive	2	3

2.0 THE GENESIS OF COMPETITION POLICY IN CANADA AND THE U.S.

While the original Canadian anti-combines legislation, enacted in 1889, and the U.S. *Sherman Act*, enacted in 1890, have often been held out as examples of "public interest" legislation where the dispersed general public interest triumphed over special concentrated private interests who stood to gain from the perpetuation of trusts, cartels, and monopolies (DiLorenzo, 1985, pp. 73, 74), there is reason for a measure of scepticism about this claim. The first Canadian competition policy statute was introduced by John A. Macdonald's Conservative government, which only 10 years before had introduced the National Policy, a central ingredient of which was high tariffs intended to nurture the growth of a manufacturing industry in central Canada. This statute was recommended by a Parliamentary Committee under the chairmanship of Conservative N. Clarke Wallace who represented the proposed statute as merely declaratory of the English common law on restraint of trade with criminal sanctions appended for non-compliance (indeed the statute was called "An Act to Declare the Common Law").[1] With respect to Wallace's claim that the legislation would nevertheless "be a terror to evil doers", Bliss (1973, pp. 182, 183) comments that "this was fraudulent political posturing, designed partly to continue to enhance Wallace's popular reputation as the enemy of combines, and almost certainly also as part of a calculated Conservative manoeuvre to deflect criticism from the combine-creating effects of the protective tariff." The Liberal Opposition apparently regarded the statute as a political ploy designed to dodge the real issue of the effects of the Conservative National Policy of tariff protection in inducing combination and monopoly and were sceptical of its likely remedial effect

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1. See Bliss (1973), (1974), Gorecki and Stanbury (1984), and Baggaley (1991).

(Bliss, 1973, p. 182). Indeed, the statute in its initial form proved almost wholly ineffectual, and generated only one (unsuccessful) price fixing prosecution between 1889 and 1900 (Gorecki and Stanbury, 1984, p. 20).[2]

The Laurier Liberals, who came to power in 1896, interestingly amended the *Customs Tariff* in 1897 to permit the Governor-in-Council to remove the tariff on any commodity found to be controlled by a combine to the detriment of the consumer (Bliss, 1973, p. 183). Such a provision has remained in the *Customs Tariff* to the present day (ss. 35 and 38) and is parallelled by a similar provision in the *Competition Act* (s. 31) and previously the *Combines Investigation Act* (s. 28). The experience under these provisions is reviewed below. The Laurier Liberals were swept from power in the general election of 1911, after proposing to implement a general free trade treaty with the U.S., which the Conservatives opposed on the slogan, "No Truck or Trade with the Yankees". This largely buried the cause of serious trade liberalization in Canada until after World War II.

In the U.S., the enactment of the *Sherman Act* entailed closely similar political connotations. Promoted by Senator John Sherman, a Republican, whose party supported high tariffs which the Democrats generally opposed, like Wallace he claimed that the legislation was merely declaratory of the common law (with criminal sanctions appended) (Letwin, 1965, pp. 91, 92). In the course of Congressional debates during the passage of the *Sherman Act*, a proposal which would have provided for the removal of protective tariffs in the event of a conviction under the Act was rejected. Within three months of the passage of the Act, as Chairman of the Senate Finance Committee, Sherman sponsored a bill popularly known as the "Campaign Contributors' Tariff Bill" (the McKinley Tariff).[3] The New York Times which had for years been one of the foremost proponents of antitrust legislation obtained an unabridged version of Sherman's speech on the tariff bill (Sherman had withdrawn it from the *Congressional Record* for "revision"):

> ...we direct attention to those passages [of Sherman's speech] relating to combinations of protected manufacturers designed to take full advantage of high tariff duties by exacting from consumers prices fixed by the agreement after competition has been suppressed....Mr. Sherman closed his speech with some words of warning and advice to the beneficiaries of the new tariff. He was earnest enough in his manner to indicate that he is not at all confident as to the outcome of the law. The great thing that stood in the way of the success of the bill, he said, was whether or not the manufacturers of the country would permit free competition in the American market. The danger was that the beneficiaries of the bill would combine and cheat the people out of the benefits of the law. They were now given reasonable and ample protection, and if they would resist the temptation attaching to great aggregations of capital to combine and advance prices, they might hope for

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[2] An analysis of the administration and enforcement generally in the period 1889-1952 can be found in Gorecki and Stanbury (1991).

[3] See DiLorenzo (1985) and Telser (1987, pp. 18-25).

> a season of great prosperity....He did hope, the Senator concluded, that the manufacturers would open the doors to fair competition and give its benefits to the people....He hoped the manufacturers would agree to compete one with another and would refuse to take the high prices that are so easily obtained (DiLorenzo, 1985, p. 83).

The *New York Times* concluded:

> The so-called Anti-Trust law was passed to deceive the people and to clear the way for the enactment of this...law relating to the tariff. It was projected in order that the party organs might say to the opponents of tariff extortion and protected combinations. 'Behold! We have attacked the Trusts. The Republican party is the enemy of all such rings.' And now the author of it can only 'hope' that the rings will dissolve of their own accord (DiLorenzo, 1985, p. 83).

DiLorenzo (1985, p. 83) interprets the promotion of these two pieces of legislation as a political logrolling exercise - the *Sherman Act* to assuage small farmers and businesses concerned about the competitive inroads of larger, more efficient organizational units, the McKinley Tariff to assuage domestic manufacturers by giving them a protected market.

3.0 THE WORLD OF SECOND-BEST

With this unpromising conjuncture of protectionist trade policies and ostensibly more assertive domestic competition policies simultaneously espoused and promoted, it is useful to review the course of Canadian competition policy in the intervening years in the light of this intersection of trade and competition policy.

While mergers and monopolies were added to the *Combines Investigation Act* of 1910, only a handful of merger or monopoly cases have ever been prosecuted in Canada, although some have been the subject of special inquiries by the Restrictive Trade Practices Commission created in 1952 (Stanbury, 1978). In reviewing the major Canadian monopoly, merger, and collusion cases that have been the subject of prosecution or special inquiry, it is noteworthy how many have involved domestic industries protected from foreign competition by substantial tariffs or other barriers to trade.

In two well known merger cases *R.* v. *Canadian Breweries Ltd.*[4] and the *R.* v. *B.C. Sugar Refinery Ltd.*[5]; and three well-known conspiracy cases, *Atlantic Sugar Refineries Co. Ltd.* v. *A-G Canada*[6]; *R.* v. *Northern Electric*

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[4] *R.* v. *Canadian Breweries Ltd.* [1960] O.R. 601.

[5] *R.* v. *B.C. Sugar Refinery Co. Ltd.*, (1960) 32 W.W.R. 577.

[6] *Atlantic Sugar Refineries Co. Ltd.* v. *A.-G. Canada* [1980] 2 S.C.R. 644.

Co. Ltd.[7] (electric cable), *Container Materials* v. *R.*[8], and *R.* v. *Canadian General Electric Ltd.*[9] (large lamps), the trial records reveal evidence of substantial tariff and non-tariff barriers to trade. It is also difficult to imagine how the alleged monopolies or conspiracies could have been sustained without significant impediments to foreign entry in *Eddy Match Co. Ltd.* v. *R.*[10] (wooden matches, monopoly), *Howard Smith Paper Mills Ltd.* v. *R.*[11] (fine paper), *R.* v. *Armco Canada Ltd.*[12] (metal piping), *R.* v. *Anthes Business Forms Ltd.*[13] (the latter three being conspiracy cases). In two 1989 merger cases reviewed by the Director of the Competition Policy Bureau, the Carling O'Keefe/Molsons brewing merger and the Pacific Western Airlines Corp./Wardair merger, interprovincial and international trade restrictions in the first case, and restrictions on foreign ownership in the second significantly exacerbated the competitive concern that the mergers raised.[14] A systematic analysis of the contexts of all the major Canadian merger, monopoly and conspiracy cases to test the significance of artificial barriers to foreign or extra-provincial competition would be a very instructive research exercise.

Assuming my hypothesis was proven that artificially constricted foreign competition was a significant anti-competitive factor in a large proportion of these cases, the second-best problem we then confront is cast in sharp relief. The problem is the most acute with respect to monopoly and merger cases. An assertive domestic competition policy incurs the risk of preventing firms attaining the minimum efficient levels of scale required to be internationally competitive, and thus provides an on-going rationale (or excuse) for the firms and industries in question for resisting trade liberalization and the pro-competitive forces that this is likely to unleash. On the other hand, to maintain both protectionist trade policies and a passive domestic competition policy with respect to mergers and monopolies is to deny Canadian consumers the benefits of both foreign and domestic competition, unless one espouses an infant industry argument that such a combination of policies is required on a limited term basis to permit local industries to achieve minimum efficient scale before confronting them with the winds of international competition. To the extent that this reasoning formed a part of the rationale for the National Policy, the effluxion of more than a century seems more than ample breathing space.

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[7] *R.* v. *Northern Electric Co. Ltd.* [1955] O.R. 431.

[8] *Container Materials* v. *R.* [1942] S.C.R. 147.

[9] R. v. *Canadian General Electric Ltd.* [1976] 15 O.R. (2d) 360.

[10] *Eddy Match Co. Ltd.* v. *R.* (1953) 109 C.C.C. 1.

[11] *Howard Smith Paper Mills Ltd.* v. *R.* [1957] S.C.R. 403.

[12] *R.* v. *Armco Canada Ltd.* (1974) 6 O.R. (2d) 521; 13 O.R. (2d) 32.

[13] *R.* v. *Anthes Business Forms Ltd.* (1976) 26 C.C.C. (2d) 349.

[14] See "Director Passes on PWA-Wardair Merger," *Canadian Competition Policy Record*, Vol. 10(2), 1989, pp. 8-9; and "Director Approves Merger of Molson and Carling O'Keefe," *Canadian Competition Policy Record*, Vol. 10(3), 1989, pp. 2-4.

In the case of cartels, an assertive domestic competition policy in conjunction with a protectionist trade policy (in sectors where foreign competition, absent artificial trade barriers, is a feasible prospect), may entail clearer welfare gains than with respect to monopoly and merger policy, although inducing a risk of horizontal integration by ownership with the same ambiguous welfare implications as noted above in the case of monopolies and mergers.

4.0 THE REFORM PROCESS

The post-war period has witnessed an enormous growth in world trade. Over the course of seven negotiating rounds under the aegis of the GATT, tariffs have dropped dramatically - average world-wide tariffs on manufactured goods have fallen from 40% in 1947 to between 5% and 6% in 1987. In Canada, tariffs on dutable products have fallen from about 25% to 9%-10% on average over this period (Trebilcock, 1988, p. 389). These trends have been significantly offset by the rise of the so-called New Protectionism and the growth of non-tariff barriers to trade (NTBs) from the early 1970s onwards. However, the evolution of the European Community and its professed goal of a single market by 1992, the consummation of the Canada-U.S. Free Trade Agreement in 1988 (with the Conservatives and Liberals, Republicans and Democrats engaging in historical role reversal), falling transportation and communication costs, the rise of multinational corporations, the increasing mobility of corporate capital, and shifting comparative advantage to Japan and the NICs, all presage intensifying international competition in the future, despite protectionist attempts to mute this process.

With this back-drop, some potential incongruities emerge in the recent evolution of competition policy. At precisely the time that Canada has chosen to further liberalize trade with the U.S. and the European Community (EC) has chosen to further liberalize internal trade, and both are engaged in efforts during the current Uruguay Round of the GATT to further liberalize trade multilaterally, both Canada and the EC have simultaneously chosen to adopt more stringent domestic competition laws - in Canada's case with respect to mergers and abuse of dominant positions and in the EC case with respect to mergers.[15]

The Canadian merger provisions are sensitive, on their face, to this potential incongruity. Section 93 of the *Competition Act* of 1986 provides that the Competition Tribunal, in determining whether a merger lessens or is likely to lessen competition substantially, may have regard *inter alia* to:

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[15] See European Community, *Merger Control Regulation* No. 4004/89, December 21, 1989. See also Marfels (1990) and Hahn (1990).

> (a) the extent to which foreign products or foreign competitors provide or are likely to provide effective competition to the businesses of the parties to the merger or proposed merger;
>
> (d) any barriers to entry into a market, including
>
> (i) tariff and non-tariff barriers to international trade,
>
> (ii) interprovincial barriers to trade, and
>
> (iii) regulatory control over entry, and any effect of the merger or proposed merger on such barriers;

In addition, in applying the so-called "efficiency defence" under S. 96, the Tribunal must consider whether efficiency gains from a proposed merger will result in (a) a significant increase in the real volume of exports; or (b) a significant substitution of domestic products for imported products. Similarly, the provisions on research joint ventures (S.95) and specialization agreements (S.86) explicitly incorporate enhanced international competitiveness as an adjudicative factor.

The risk with both these sets of reforms is that, unless sensitively applied, competition policy in Canada and the EC will move in the opposite direction from that dictated by changes in trade policy, and the dissonance that has existed between trade policy and competition policy since the genesis of the latter will be perpetuated in a new form. In order to minimize this risk, careful attention is required in enforcement priorities and adjudicative policy to the need to reconcile the implications of an increasingly competitive international trading environment and contemporary domestic competition policy. More specifically, an increasingly light and sensitive touch will be required in the administration of domestic competition policy in recognition of the increasingly competitive international environment, or we risk hobbling our domestic firms as they gear up to meet less constrained foreign competition in either their export or domestic markets. This problem is particularly acute in a small, open economy such as Canada's. It may be that in other economies, such as Japan's, where allegedly collusive or exclusionary distribution practices may operate as serious non-tariff barriers to trade, a more assertive competition policy than the perfunctory policy that presently exists would function as a major complement to a liberal trade policy. I conclude these comments with a brief review of some of the policy implications of the trade and competition policy relationship for Canada.

5.0 RECONCILING CONTEMPORARY TRADE AND COMPETITION POLICIES

As a matter of enforcement priorities, the Bureau of Competition Policy would seem well advised, in its administration of the new merger[16] and abuse of dominant position provisions,[17] to make it clear that in sectors where no artificial constraints on foreign competition pose serious barriers to entry, or where they are being phased out, and where transportation costs are not an inherent barrier to foreign entry, they are unlikely to subject mergers or dominant positions to close scrutiny. In other words, the Bureau should take an expansive view of the definition of the relevant geographic market. In pursuing such an approach, the Bureau would also be well advised not to adopt too static an approach, but give firms some leeway to gear up pre-emptively to meet potential foreign competition that has not yet emerged but is not impeded by present or prospective trade barriers.

This would suggest a redirection of focus from some merger contexts to contexts where foreign competition is not an imminent competitive threat, such as local protected service sectors where entry barriers are significant. Here the Bureau has been surprisingly lenient in dealing with local cartels as reflected in recently negotiated prohibition orders in the case of local real estate agent and lawyer cartels (see the paper by Stanbury in Part 2 of this volume).

With respect to adjudicative policy, the same considerations obviously are pertinent. However, two additional issues arise. First, reinforcing the tenor of the *Canadian Breweries* decision,[18] the Supreme Court of Canada decision in *Jabour*[19] to a significant degree immunized provincially regulated service sectors from the application of the *Competition Act*, despite the fact that these sectors are most insulated from foreign and often inter-provincial competition and through self-regulatory bodies or trade associations are often tempted to engage in anti-competitive collusive behaviour. This so-called regulatory exemption requires rethinking, either judicially or legislatively, if protected local fiefdoms are to be exposed to maximum feasible competitive discipline (see Part 7 of this volume).

Second, in merger and abuse cases involving industries that enjoy and are likely to continue to enjoy significant trade protection where foreign competition would otherwise be a feasible prospect, as a matter of principle the remedy of choice where serious competitive concerns are present should be a trade liberalization remedy rather than a structural remedy, simply because the former offers the prospect of new entry which the latter does not.[20] Here, it bears recalling that S. 31 of the *Competition Act* provides:

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[16] See the Director of Investigation and Research's (1991) *Merger Enforcement Guidelines*; Crampton (1989).

[17] See Hunter (1990) and Thompson (1991).

[18] *R.* v. *Canadian Breweries Ltd.* [1960] O.R. 601.

[19] *Jabour* v. *Law Society of British Columbia* [1982] 2 S.C.R. 307.

> Whenever, as a result of an inquiry under this Act, a judgment of a court or a decision of the Tribunal, it appears to the satisfaction of the Governor in Council that
>
> (a) competition in respect of any article has been prevented or lessened substantially, and
>
> (b) the prevention or lessening of competition is facilitated by customs duties imposed on the article, or on any like article, or can be reduced by a removal or reduction of customs duties so imposed,
>
> the Governor in Council may, by order, remove or reduce any such customs duties.

Moreover, S. 99 of the *Competition Act*, as part of the new merger provisions, empowers the Tribunal to make conditional orders requiring dissolution or divestiture unless within a reasonable time custom duties have been removed, reduced or remitted or prohibitions or restrictions on imports have been removed or reduced. Section 86(4) of the Act similarly empowers the Tribunal in reviewing specialization agreements, as does S. 75(1) in the case of refusals to deal, although the terms of the latter provisions are (foro no obvious reason) confined to tariffs. Anomolously, no such specific discretion has been vested in the Tribunal in abuse of dominant position proceedings (ss. 78, 79) or vertical practices (exclusive dealing, tied selling, market restrictions, consignment selling: ss. 76, 77) nor in the event of horizontal collusion (S. 45), predatory pricing (S. 50), or resale price maintenance (S. 61) cases. The absence of this discretionary power is important in that its existence encourages the Tribunal to take a trade liberalizing initiative, to which the government must respond, while S. 31 contemplates that the initiative resides with the Governor-in-Council (in effect the Federal Cabinet).

While, as noted above, S. 31 has a long history dating back to 1897, there appears to have been only one instance in which it has been invoked (Gorecki, 1981, pp. 185-197). In 1902, the Minister of Finance W.S. Fielding, at the behest of the powerful Canadian Press Association, recommended to the Governor-in-Council that the duty on news printing paper in sheets be reduced from 25% *ad valorem* to 15% *ad valorem*. The MacQuarrie Commission in 1952 in recommending the creation of the Restrictive Trade Practices Commission, to be invested with special inquiry powers, stated: "We propose that the [R.T.P.C.] should envisage the possible effectiveness of tariff action in every case presented to it and report its findings in this respect."

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[20] Generally, see Goldman and Bodrug (1990).

As detailed in Appendix A, between 1952 and 1975 the RTPC recommended tariff reduction action in six cases, following special inquiries, but in not one case was their recommendation acted upon. However, in the recent Consent Order proceedings before the Competition Tribunal in the Power Transformer case (Asea Brown Boveri Inc.), the acquiring party, as a condition of the Director's approval of the merger, agreed to an accelerated elimination of 13.5% tariffs on U.S. imports duty remissions on 15% tariffs applicable to non-U.S. imports, and undertook not to initiate anti-dumping proceedings against importers for five years from the approval of the merger.[21] In the event of the Minister of Finance not acting on the tariff proposals within a specified time, certain divestitures were agreed to as an alternative response.

As presently structured, some questions may be raised as to the S. 31 remedy and the related discretion vested in the Tribunal to make conditional orders under S. 99, S. 86(4) and S. 71(1). First, the Tribunal can only recommend to the federal government the elimination or reduction of duties and other trade restrictions, and the government can act on such a recommendation merely by executive order. This raises due process and accountability concerns that were sought to be avoided by the current merger provisions which reflect a rejection of an earlier proposal to permit Cabinet appeals from Tribunal decisions in merger cases. Increased reliance on the S. 31 remedy risks politicizing the merger review process. On the other hand, it is difficult to imagine the government ceding dispositive responsibility for tariff reductions to an administrative agency, given the international politics of tariff reductions and the political desire to negotiate reciprocal concessions for concessions of our own. Second, there is the potential for over-breadth in the remedy in that the reduction or elimination of a tariff is likely to affect other firms in an industry beyond those directly involved in merger or abuse proceedings, who will see themselves placed at prejudice in proceedings to which they have not been primary parties. Third, the Act is not consistent in vesting the Tribunal or courts with the power to make orders conditional on trade protection relief in all relevant competition policy contexts. Fourth, the S. 31 remedy is confined to tariffs and does not extend to non-tariff barriers to trade, such as quantitative restrictions or quotas (an increasingly prevalent form of trade restriction in the "New Protectionism"), nor of course does it apply federally or to provincially-induced inter-provincial barriers to trade or provincially-induced anti-competitive restrictions on entry. It is important to note, however, that the discretion vested in the Tribunal to make conditiona orders under S. 99 and S. 86(5) extends to quantitative restrictions, although S. 31 probably should be amended so as to make it clear that the Governor-in-Council has authority to respond to conditional orders that relate to quantitative restrictions. This power already probably exists, given that most import quotas are presently imposed by Order-in-Council under the *Export and Import Permits Act*,[22] although any doubts in this respect should be removed.

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[21] See *Canadian Competition Policy Record*, Vol. 10(2), 1989, pp. 10-11; Vol. 10(3), 1989, p. 9; and Vol. 10(4), 1989, pp. 12-13.

As to the first problem, by way of extension of the approach adopted in the negotiated Consent Order in the Power Transformer case, the Tribunal in contested proceedings could propose a default structural remedy under S. 99 in the absence of government action within a specified time frame on a trade liberalization recommendation. Hopefully, the structural remedy would be sufficiently unpleasant that the merging parties would become major lobbyists for trade liberalization action. As to the second problem, in any proceeding where the Tribunal might wish or is asked to consider a trade liberalization remedy, other firms in the industry could be notified and given standing in the proceedings. Moreover, if serious competitive concerns are uncovered (i.e. they are shown to be ineffective competitors), it is not clear why they should enjoy an immunity from new foreign entry. As to the third problem, the *Competition Act* requires amendment to provide for an initiating power in the Tribunal or court in all relevant competition policy contexts to make orders conditional on trade protection relief. In other words, this should be considered a live issue in all competition policy proceedings. As to the fourth problem, S. 31 could easily be amended to include non-tariff barriers such as quantitative restrictions. Inter-provincial barriers to trade have proved an intractable domestic political problem and have received much less serious attention in federal-provincial relations than they deserve. Perhaps an increasingly expansive judicial view of the trade and commerce power[23] will provide greater purchase on these. Intraprovincial regulatory restrictions on entry seem even more impervious to federal influence. However, in the case of both inter-provincial and intra-provincial barriers to trade, aggressive exercise by the Director of Investigation and Research of his representational power under ss. 126 and 126 of the Act may be the most effective corrective available to him with respect to anti-competitively inspired forms of domestic regulation (see the paper by Monteiro in Part 7 of this volume).

6.0 CONCLUSION

While the initial enactment of competition laws in Canada and the U.S. have attracted tenable claims of political fraud in that they can be viewed as attempts to disguise the serious anti-competitive effects of high tariff policies that were simultaneously espoused, interring the last vestiges of the National

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[22] R.S.C. 1985, C. E-19.

[23] See e.g. *General Motors of Canada Ltd.* v. *City National Leasing* [1989] 1 S.C.R. 641.

Policy in Canada of 1879 requires us to re-think the relationship between competition and trade policy so that the former does not constrain the benefits of the latter in an increasingly global economy. When we have achieved this reconciliation between trade and competition policy, we will have completed a task that has eluded policy-makers for a century - the achievement of two economically coherent and consistent framework policies that are major policy determinants of the competitive health of our economy.

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Appendix A

Reports of the Restrictive Trade Practices Commission Which Recommended Tariff Reductions: 1952-1975

Date of Report	Product	Concentration[1]	Tariff Level[2]	Offence	Action Subsequent to Tariff Recommendation	Report's Publication
June 20/56	Boxboard Grades of Paperboard	50/4 in 1954	M.F.M. 22½%	Conspiracy (All of Canada except B.C., Saskatchewan and Alberta)	"Consideration could be given to the reduction or removal of import duties" if a reasonable degree of competition is not restored."	No tariff reduction. Conviction on Conspiracy charge obtained.
July 3/58	Zinc Oxide	94/2, 80/1 in 1956	M.F.N. 12.5%	Merger, Price Discrimination (Canada)	"That consideration be given to the removal of the customs duties on refined zinc."	No tariff reduction, no court proceedings, no undertakings given by industry.
Feb. 3/59	Ammunition	95/1 in 1958	M.F.N. 22½%	Monopoly (Canada)	"The Commission recommends that the continuance of a protection tariff... should be conditional upon Canadian Industries Ltd. giving an undertaking that it will abandon the restrictive distribution policy it has followed in limiting the number of direct accounts."	No tariff reduction since C.I.L. advised Department of Finance it was revising its distribution policy in a manner which met R.T.P.C.'s recommendations. Effective Jan. 1, 1961. (Note: C.I.L. had changed its sales policy in response to a similar inquiry dated Sept. 3, 1940.)
Feb. 3/60	Sugar	90+/3 in 1954	Effective Protection of $1.22 per cwt of Refined Sugar	Conspiracy (Eastern Canada)	"Tariff clearly impacts adversely on competition. In future trade negotiations this factor should be considered."	No tariff reduction, three sugar refineries convicted of conspiracy.
Aug. 2/62	Container Board[3]	81/4 in 1960	M.F.N. 22½% (In 1962 raised to 27½%.)	Conspiracy and Merger (Canada)	"The foregoing analysis leads the Commission to the conclusion that the most effective way to restore competitive conditions to... this industry, from which the public would derive benefit in the form of lower prices, would be the removal of customs duties...	No tariff reduction. Conviction on a conspiracy charge obtained. (Note: A similar conviction was secured in 1940.)

Appendix A - continued

Date of Report	Product	Concentration[1]	Tariff Level[2]	Offence	Action Subsequent to Tariff Recommendation	Report's Publication
Jan. 14/71	Electric Large Lamps	90-95/3 in 1965	M.F.N. 30%	Conspiracy, Monopoly and Resale Price Maintenance (Canada)	"The protective tariff has made it possible for the Canadian manufacturers to delay price reductions and even to make advances in prices when prices in foreign countries have been moving downward. The Canadian Customs Tariff on electric large lamps should be carefully reviewed and reductions in rates of duty should be considered to encourage comeptition in the supply of lamps to Canadian users."	No tariff reduction. Conviction on a conspiracy charge obtained. (Note: The leader of the conspiracy, Canadian General Electric, had already been convicted in a previous conspiracy case in 1955 involving electric wire and cable.)

1. Should be read (say, for electric large lamps) the largest three enterprises account for between 90-95 per cent of domestic consumption. The column headed "Offence" contains, in parentheses, the relevant geographic market.

2. A range of tariffs applies to any item. The most relevant one is presented in the table.

3. The Report related to both containerboard and paperboard shipping containers. The tariff recommendations applied to both markets. Many of the same enterprises were involved in both markets (i.e., vertically integrated).

Source: *Annual Report* (various years), R.T.P.C. (1956, 1958a, 1959, 1960a, 1962a, 1971) and Skeoch (1966, pp. 97-145).

Source: Paul K. Gorecki (1981) *The Administration and Enforcement of Competition Policy in Canada 1960-1975* (Ottawa: Consumer and Corporate Affairs Canada), pp. 185-197.

Chapter 5

TRADE POLICY AS COMPETITION POLICY

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1.0 INTRODUCTION

The body of policy embodied in Canada's competition laws acts on the structure of Canadian industries, and on the behaviour of the firms within those industries. A recurring conflict posed in the application of competition policy to a supposedly "small" economy like Canada is the possibility of an unpleasant trade-off between competitive behaviour and efficiency. The Canadian market may not be big enough to support efficient-sized firms unless the number of these in each industry is allowed to be small enough so that the market will no longer be competitive.

Trade policy -- specifically, the Canada/US Free Trade Agreement (FTA)-- may seem to offer a way out of the small country impasse. By increasing the degree of competition from imports, domestic firms will be prevented from achieving non-competitive markups while at the same time being allowed -- indeed, forced -- to make whatever rationalisations of their industries are needed to achieve efficient scales of production.

This paper will assess the evidence on the use of trade liberalisation as a substitute for structural competition policy. While the focus will be on the impact of tariff reductions, as in the FTA, attention will be paid to other relevant results, including the literature on non-tariff barriers.

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[*]. The author thanks Don West for his comments. Tom Ross, the discussant of the paper, made a number of sensible suggestions which he generously allowed to be incorporated into the revision of the paper. This paper was written while the author was a visitor in the Department of Economics at Carleton University, who are thanked for their hospitality.

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Section 2 surveys theoretical models of pricing and the tariff. Section 3 assesses these models against the empirical evidence. Section 4 is concerned with non-tariff barriers, and Section 5 concludes the paper.

2.0 TARIFF POLICY: THEORY

Elimination or reduction of an import tariff can be expected to reduce the price of the import in the domestic market, and thereby induce some matching response in the price of competing domestic output. As noted in the Introduction, this is the essence of the case for using tariff reductions as a substitute for competition policy.

This section will examine the theoretical case for such use of tariff policy, by listing and analysing the models that have been developed to generate predictions on the domestic response to foreign suppliers' market behaviour. We will find a number of such models, with a full range of predicted outcomes, from 100% matching of any cut in tariffs, to no pricing impact at all.

A rough generalization that emerges from this survey is that the pro-competitive impact of a tariff cut is inversely related to the complexity of the model, in the sense of the range of factors taken to be endogenous. Thus, models with endogenous behaviour of imports give smaller tariff-pricing impacts that those in which import supply is exogenous, and the pro-competitive effect may be diluted if the number of domestic firms is responsive to price changes.

Four sub-sections follow -- three dealing with the product market implications of tariff changes for domestic output pricing; the fourth adding the additional consideration of input market response -- that is, entry and exit.

2.1 Small Country Models

Eastman-Stykolt: The classic contribution to Canadian thinking on the industrial organisation implications of tariff policy is the model first set out by Stefan Stykolt and Harry Eastman (1960). In the Eastman-Stykolt (E-S) model, a small group of colluding Canadian oligopolists set the price of a homogeneous product at or just below the exogenous world or U.S. price, inclusive of the Canadian tariff, so that imports are excluded from the domestic markets.[1]

The E-S model gives the maximum pro-competitive bang for the trade liberalisation buck. Domestic prices fall by the full amount of the tariff cut, because of perfect collusion at the focal point, and because the supply of imports is perfectly elastic. Furthermore, the lower prices are not just transfers from shareholders to consumers (with a small "triangle" of allocative efficiency gains), but lead to matching production efficiency gains. Such occur because E-S assume, in curious contrast to perfect collusion in product markets, that domestic oligopolists are helpless to prevent entry into their industries, which therefore occurs until all profits are competed away. In the "small country" world of E-S, scale economies matter (the domestic market will not support a large number of scale-efficient firms), so entry "crowds" an industry, forcing all firms up their average cost curves. Conversely, exit induced by lower prices after tariff cuts results in rationalisation and more scale-efficient production. These rationalisation effects will be further discussed in section 2.4.

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[1] In a more modern interpretation -- see Harris (1989, p.11) --the tariff-inclusive import supply price is a "focal point" around which oligopolists can coordinate to set their own price, without explicit, illegal collusion. In this formulation, domestic output and imports need not be homogeneous (perfectly substitutable), so that, even with domestic output price set at the focal point, some imports may enter the market. This is clearly more widely realistic than the assumption that imports are excluded completely.

Given Canadian tariffs on manufactured products averaging around 10%, the price reductions promised by tariff cuts in the E-S model must certainly be considered significant relative to the sort of changes in pricing conduct that might be achieved by aggressive use of structural competition policy. Consider, for example, the standard conjectural variations non-cooperative homogeneous product oligopoly model (Waterson, 1984, p. 19). In this, we get (for the simple similar-sized firms case)

$$(1)\ (p-c)/p = (1+v)/(Ne) \qquad (1)$$

where p is unit price; c is marginal cost; v is the "conjectured" change in all other firms' output induced by a unit change in a particular firm's output; N is the number of firms in the industry, and e is the absolute value of the industry price elasticity of demand.

The average value for the Herfindahl index of seller concentration in Canadian manufacturing is 0.11, which implies a "numbers equivalent" of about nine (an industry made up of nine equal-sized firms has a Herfindahl of 0.11). Suppose, in such an "average" industry, that the application of competition policy succeeds in increasing by one the number of firms (preventing the elimination of a firm is more realistic, but never mind). According to equation (1), increasing N from 9 to 10 would reduce profit margins by about 10% -- perhaps a little more, if the conjectural variations parameter falls as the number of firms increases. Measurement of profit margins is contentious, but let us take 20% to be a reasonable figure. Then, the structural change in the number of firms will result in a 2% fall in the industry price --well below that promised by elimination of the tariff.

These models and numbers are not intended to be taken very literally, but they do illustrate the case for tariff policy as a substitute for structural policy, at least in the Eastman-Stykolt world. Attempts to formalise the E-S pricing model within the framework of oligopoly theory have been made by Hazledine (1988a) and Muller and Rawana (1989). So long as a reason can be found for kinking the demand curve at the import-barring or limiting price, these models can generate three possible discrete outcomes -- market sharing with imports; limit pricing; and pricing below the limit price (due to inability of oligopolists to coordinate their pricing in their joint interests).

With the third outcome, the tariff is, at the margin, redundant, and small reductions in it will have no effect on the domestic price. Larger reductions will, however, eventually induce the domestic oligopolists to respond by setting the limit price, which is the price that would be charged by a monopolist or collusive oligopoly. Thus, it can appear that a tariff cut has led to a less "competitive" regime in the domestic market. However, since the market outcome is a lower price, the appearance of as-if collusive behaviour is not a matter of concern (unless, having achieved import-barring coordination, the oligopolists are encouraged to develop other forms of cooperative, non-competitive practices).

In summary, tariff policy is likely to be at its most effective as a substitute for competition policy in situations where the *prima facie* case for the latter is strongest -- that is, in concentrated, collusive industries. In more atomistic market structures, theory predicts that domestic firms will be less likely to be able to coordinate pricing to take advantage of tariff protection, so that reductions in the tariff will be correspondingly less effective. But, of course, in such industries, the need for any sort of pro-competitive policy is also less pressing.

Globerman (1988, p.17) has made the related point that, if collusion is costly (because of enforcement costs, say) then it will be less likely to occur, the more profits are already boosted by tariff protection. So, losing the protection could force firms to take on the task of colluding. Again, though, it is difficult to see how the net result of this could be a price higher than that charged with the tariff, and thus a net deterioration in market performance requiring a more energetic competition policy to compensate.[2]

Models With Imports as a Fringe: What if imports are exogenous in the sense that importers do not respond directly to actions in the Canadian market, but, because of transport costs, the supply of imports is not perfectly elastic? Then we have what, in the standard oligopoly theory, is called an exogenous "fringe" of suppliers of imported product (e.g., Perry and Porter, 1985).

Models in which domestic oligopolists set price given an exogenous supply curve of imports have been built by Hazledine (1985) and Ross (1988a,b). The Ross model is explicitly directed at the questions addressed in the present paper, and we will focus on it here.

Note at once that having an upward-sloping supply curve for imports must reduce the impact of the tariff on domestic price and, thus, the potential pro-competitive role for tariff cuts. This is because the tendency to supply more imports, following a tariff cut, will be diluted by the increase in the supply price at higher volumes, so that even a perfectly colluding domestic industry matching one-for-one the Canadian market price of imports will end up not reducing their price by the full amount of the tariff cut. With imperfect domestic collusion, the price effect is smaller still, basically, because all responses to exogenous shocks are muffled when the decision-makers cannot coordinate completely.

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[2] A possible exception: in a differentiated products world, domestic firms may be content to take the benefits of a tariff in the form of higher market share -- higher volume. Absent the protection, they may turn to higher margins as a means of making money.

Ross's contribution is to note that domestic firms' response to a shift in the import fringe supply curve (due to a tariff cut) depends, *inter alia*, on the elasticity of "residual" demand (total market demand less fringe supply), and that this elasticity can change with the shift in the fringe curve. It is even possible, though probably pathological, that this elasticity can fall, and by enough to induce the domestic oligopolists to increase price, following the tariff cut.

The motivation for this result is given by an extreme example -- that of a domestic monopolist finding it profitable, in the tariff-on situation, to price so as to exclude all imports from the domestic market. After elimination of the tariff, import-barring pricing may become unattractive (at the new, lower price required), and the monopolists may, instead, decide to cede market share to imports and charge a higher price on a lower volume of domestic output. While readily admitting that such a perverse outcome is "unlikely" (1988a, p. 512), Ross feels that the overall tenor of his results justifies the statement that "domestic buyers need not be big winners from free trade" (*ibid.*).

In his 1988b paper, Ross analyzes the case of a domestic oligopoly facing fringe imports, and asks the interesting question: "how will lower tariffs alter the price effects of mergers?" (p. 239). That is, can tariff policy affect the incentive for domestic firms to merge to gain market power (and, thus, the need for competition policy to counter such mergers)?

As with the monopoly model, the answer depends on the shape of the fringe supply curve and how this changes with lower tariffs; in particular, on whether import supply tends to become more elastic at higher domestic prices (if so, then cutting the tariff will reduce the domestic price at which elasticity increases and thereby reduce the incentive to merge).

2.2 International Oligopoly

If the suppliers of imports are also oligopolists, then modelling the impact of the tariff and of tariff cuts becomes much less simple. Even in the homogeneous goods case, with domestic and importing firms supplying identical products to the domestic market, price will not, in general change by as much as the change in the tariff.

A number of models have been analysed. Some of these have been motivated by the large swings in real exchange rates observed recently in the United States -- swings which imply that changes in nominal exchange rates have not been fully passed through in changes in market prices. Some explanations for this phenomenon have looked towards adjustment costs leading to lags, others have turned to imperfect competition and oligopoly theory. It is the latter group of models that are relevant here, since tariff changes are (presumably) permanent, so that short-run adjustment lag effects are not particularly interesting.

A permanent change in the exchange rate is equivalent, in a partial equilibrium model, to a (permanent) change in the tariff: both have the same effect as a change in the costs of the foreign supplier to the domestic market. Dornbusch (1987) shows that, in a Cournot homogeneous oligopoly model, the elasticity of domestic price with respect to the exchange rate is a multiple of the market share of imports and the marginal cost/price ratio of foreign suppliers. Since both these terms are less than one, so too must be the elasticity -- considerably so when, as is usually the case in Canada, import market shares are quite small.

Ross (1988b) builds one of these "international oligopoly" models, and uses it to address the question raised above, on the link between the tariff and the incentive for firms to merge to gain market power. In this context he does conclude that, with a lower tariff, "mergers reducing [the number of domestic firms] will not result in price increases as large as they would have been" (p. 243), so that tariff policy can be a substitute, at least partially, for structural competition policy.

Interestingly, a merger of two foreign firms will have a greater effect on price if tariffs are lower. This is because, with a lower tariff, the foreign share of the domestic market is larger, and so the elimination of a foreign firm withdraws more output from the market, permitting a higher price.

In summary, modelling importers as oligopolists tends to reduce the domestic price impact of tariff protection, basically because, with (conjectured) marginal revenue curves being equated to marginal costs by foreign firms, a tariff (which is equivalent to an increase in costs) will not have such a large effect on price as when it is the intersection of the average revenue (demand) curve with costs, when the "world" is competitive.

A lower tariff worsens the market situation of domestic firms. Will this deterioration make it more or less likely that they turn to mergers to improve profitability? Ross's results suggest that lower tariffs make mergers less profitable.

An issue not considered here is the role of multinationals. What if the international oligopolists have the same owners? If this industrial structure results in pricing practices which are rather unaffected by tariffs (pricing for market share, for example), then the competitive role for tariff policy is likely to be diluted accordingly. But, it is not clear that single-country structural competition policy is effective in this world, either.

2.3 Monopolistic Competition Models

If domestic firms are monopolistically competitive, each will set price of its differentiated product assuming no reaction from other firms, including importers. Tariff changes can only affect domestic prices if they change the perceived elasticity of demand faced by firms. Dornbusch builds a "Dixit-Stiglitz" model in which exchange rate changes (equivalent to tariffs) have no effect on the domestic price. Other models of this type (Harris and Cox, 1984) can generate small changes in elasticities with tariff cuts, such that the latter do result in domestic price changes, but these effects are not large.

In this respect, modelling the domestic economy as monopolistically competitive yields results that differ little from those generated by the constant returns, perfectly competitive assumptions of neoclassical general equilibrium trade models. In these, tariffs have no direct impact on market pricing conduct, and so do have a large impact on relative domestic market prices of imports and local production. Thus the effect of a tariff is to protect domestic industry's market share, not its profit margins.

However, monopolistically competitive models can deliver an interesting twist if scale economies are really important. Then, the increase in domestic market share can lead to higher output per firm, lower costs, and thus lower prices due to the tariff. The same result can occur in an oligopoly model context when protection of market share induces entry, making the industry behave more competitively (as in equation (1), for example) and so squeezing profit margins and prices, with or without a reinforcing scale economies effect on unit costs.

Models like these hark back to the old "infant industry" or "national development" rationales for tariff protection, as well as being related to the modern literature on "strategic" trade policy. They have been examined by Venables (1985), and applied to European Community markets by Venables and Smith (1986).

2.4 Models with Endogenous Entry

The models discussed above have either assumed the number of firms to be fixed, or have, in the work of Ross, discussed the incentive for existing firms to merge. What happens if we make fully endogenous the size of the domestic industry? Mainstream industrial organisation has, of course, paid much attention to the role of entry barriers and entry deterrence in determining market structure. Existing trade models do not, unfortunately, reflect the richness of results to be found in the IO literature. Either the number of firms is fixed, or there is free, "competitive" entry such that all profits are competed away.

As noted in section 2.1, the free entry assumption plays a major -- indeed, crucial -- role in the spectacular efficiency gains promised of tariff liberalisation in the Eastman-Stykolt model. Such gains were shown to be magnified further when general equilibrium effects are taken into account in the now-famous modelling project of Richard Harris and David Cox (1984) which provided the key analytical underpinning for the FTA.

To recapitulate; what happens in the E-S world if tariffs are cut is, first, a matching cut in the domestic price, which makes all domestic firms suddenly unprofitable; second, exit of some firms because of the unprofitability; third, improved profitability of the survivors as they increase output and move down their average cost curves.

From an industrial organisation perspective, there are at least two questions that might be asked of the Eastman/Stykolt/Harris model. First, what might be the effect on pricing behaviour of the rationalisation of industry structure following trade liberalisation? Harris and Cox's (1984) industry-by-industry results reveal some massive reductions in the number of firms -- a halving is not uncommon. In most oligopoly pricing models, reducing the number of firms facilitates collusive or as-if collusive behaviour, and so leads to price increases. In the model of equation (1) above, for example, halving the number of firms at least doubles the profit margin -- more than doubles if, as is plausible, the conjectural variations parameter v rises as N falls.

Now, it is surely not possible that the price-increasing effect of rationalisation could be larger than the price-reducing effect of the tariff cut (or else there would be no pressure to rationalise in the first place), but it is conceivable that a rationalised industry would behave less competitively in other respects, reducing the non-price dimensions of competition in the domestic market. Thus, tariff reductions could, on balance, increase the need for direct competition policies, rather than substitute for them. This is a matter which does cry out for further research.

The second question that an IO specialist might ask is: "what would happen to the free trade gain numbers if we replaced the free entry assumption with (partially) impeded entry, more in keeping with the market power granted to domestic firms in their product market pricing behaviour?" This question has been addressed in my 1990 paper, in which I attempt to "model the models" -- explain the differences in free trade gain numbers forthcoming from the large general equilibrium models -- as well as examine the implications of some different scenarios. One of these includes new-firm entry that responds only sluggishly to changes in profit margins. This means that incumbent firms earn rents, which can be used to absorb some of the losses when prices are forced down by cheaper imports. Thus, there is less need for rationalisation and so less of a productivity improvement from free trade.

In summary, there may be legitimate concerns that the rationalisation that is widely expected to be induced by free trade will reduce the extent of competition in the economy, even as it does achieve directly one of the major goals of competition policy, namely, lower prices. A qualification is that, if the economy is already significantly imperfectly competitive, tariff cuts may be absorbed in lower profit margins without much further effect on market structure.

3.0 TARIFF POLICY: EMPIRICAL EVIDENCE

The theoretical models surveyed in section 2 generated a wide range of predictions about the pricing effects of tariff policy. This is another way of saying that theory is not, by itself, able to settle the issue addressed in this paper; namely, the role for trade policy as a possible substitute for competition policy. Empirical evidence is needed. This section surveys the available empirical work, focusing on two questions that the theoretical models throw up: (a) how strong is the linkage between tariffs and domestic prices; and (b) what is the evidence, if any, for the rationalisation effects that are so important to the Eastman-Stykolt-Harris story.

3.1 Pricing and the tariff

Two sorts of evidence are available: direct studies of pricing behaviour, and indirect evidence from "structure-performance" analyses of the relationship between profitability and dimensions of market structure, which may include protection from imports.

Pricing: Eastman and Stykolt predicted that the tariff would induce an increase in domestic price, but only in industries concentrated enough to be able to collude to take advantage of the protection. Hazledine (1980) tested this proposition with a cross-section of Canadian and US manufacturing wholesale prices for 33 industries, measured in 1972. The results support the E-S model: the extent of pass-through of the tariff into domestic output price was positively related to the Herfindahl index of seller concentration in the Canadian industry, such that only in highly concentrated industries (with a Herfindahl equal to about 0.3) was there complete pass-through.

In later (and still preliminary) work on a larger sample of prices (for 212 commodities) in 1982, I found that the interactive concentration-tariff effect still exists, though the size of the pass-through coefficient appears to be smaller than it was with the 1972 data (Hazledine, 1988b), possibly because the lower real value of the Canadian dollar in 1982 reduced the influence of external forces on domestic pricing.

My model assumes that the US price is exogenous, in keeping with the postulates of the E-S model. Karikari (1988) has tested this assumption in his analysis of rates of change of prices across manufacturing industries. He finds that prices of imports into Canada do not necessarily move in close step with US domestic prices, giving some support to the "international oligopoly" approach to modelling.

Recent US studies of the exchange rate effect on pricing are relevant here. These all show that the "law-of-one-price" does not hold, so that it should not be expected that, in general, a tariff cut will be fully reflected in domestic pricing (see Froot and Klemperer (1989), Cumby and Huizinga (1988)).

Structure-Performance Studies: Regressing a measure of industry profitability on a set of "structural variables" for a cross sectional manufacturing data is a familiar exercise to industrial organisation specialists, though there is not a lot of recent Canadian work in this area. Globerman (1988, pp. 38-41) surveys some of the empirical evidence. It appears that there is a tendency for a higher import market share to be associated with lower domestic industry profitability.

However, such a correlation is a long way from establishing a causal link from import competition to domestic pricing, for at least two reasons. First, to the extent that low profitability is caused by low productivity, prices may be higher in relatively unprofitabile industries, thereby inducing a higher import market share. That is, causation could be reversed.

Secondly, import share is not a good measure of the pressure of protection. Recall that, in the pure E-S model, there are no imports, as the pressure of import competition is such that domestic firms are forced to price so as to exclude foreign competition.

More relevant, of course, would be statistical linkages between profitability and direct measures of effective or nominal protection. Such are rare. For Canada, McFetridge (1973) was unable to find a statistically significant relationship. However, for a sample of about 100 Canadian industries, I did find evidence for an interactive tariff-concentration impact on profits, just as there is on prices (Hazledine, 1985). Very interestingly, it appears that it is only through its interaction with tariffs that concentration affects profitability in Canada.

In summary, there is quite good statistical evidence that tariffs have a direct effect on domestic output prices in Canada, though not to the extent assumed in the Eastman-Stykolt model. That the tariff-price linkage appears to exist only in highly concentrated industries does not at all weaken its relevance to the issue addressed in the present paper, since it is concentrated industries that are the traditional focus of competition policy.

3.2 Evidence on Rationalisation

The Harris and Cox (1984) model's predictions of huge welfare gains to Canada from bilateral free trade with the United States were no doubt influential in the Canadian government's strong support for the FTA. They have, however, aroused some scepticism, based on doubts that domestic firms would not do something about the scale inefficiencies supposed fostered by tariff protection even without any trade liberalisation, given the large sums of money they could, as a group, potentially realise by so doing (see Muller (1982); Globerman (1988, p.8).

What is the evidence? By far the most active research program in this area has been that of John Baldwin and Paul Gorecki (1986), who have studied in great detail the structural changes occurring in Canadian manufacturing industries over the decade of the 1970s -- the period after the implementation of the generally substantial tariff cuts negotiated under the Kennedy Round of the GATT.

There is not space to record here all of Baldwin and Gorecki's results (see Part 3 of this volume). Their research was nearly, but not quite exhaustive. What they do not report is any attempt to link changes in tariff protection, as a result of the GATT, with changes in productivity -- the outcome predicted from the rationalisation process upon which the Harris-Cox numbers depend.

However, Baldwin and Gorecki do show regressions linking structural change (increases in plant scale, in particular) to changes in protection. Thus, their findings do appear to give some support to the process of tariff cut-induced rationalisation, while not revealing evidence of any "bottom line" effect -- that is, of a resulting pay-off in higher productivity. Nor does it seem reasonable, to me, to use the Baldwin-Gorecki data, which show that 16% of manufacturing shipments in 1979 were by firms entering their industry after 1970, as evidence in support of the free entry assumption, as do Horstmann and Markusen (1986).

Overall, the conclusion of Dani Rodrik (1988b, p. 21), following a survey of international evidence on the role of trade liberalisation in closing technology gaps (which is essentially what is at issue in Canada) seems sensible: "Until more evidence becomes available, then a healthy skepticism is in order."

4.0 NON-TARIFF BARRIERS

The paper has focused on the possible use of tariff cuts as a substitute for competition policy. Under imperfectly competitive conditions, however, tariffs and non-tariff barriers, such as quantitative restrictions on trade, are not equivalent, and there is a small literature which has taken account of this, and which is relevant to our concern with competition policy.

Richard Harris (1989) offers what seems to be a plausible interpretation of the impact on competition of a quota on imports (also known as a "voluntary export restraint" on foreign firms). In the duopoly situation, for example, with one domestic and one foreign firm, a quota on exports by the latter turns the domestic firm into a price leader, since it knows that, at least so long as the quota is binding, the foreign firm will always choose to supply that amount, no matter what quantity is put on the domestic market by the domestic firm. Thus, quotas are a "facilitating practice" for collusion, and can be expected to lead to higher prices of both foreign and domestic output.

Surprisingly, perhaps, this conclusion is controversial. Rotemberg and Saloner (1989) examine the issue of the sustainability of collusion, which they say depends on the severity of punishments that can be meted out to a defector from the collusive agreement. Suppose that domestic firm(s) are potential defectors. What sort of deterrence can the foreign firm manage? Under a tariff regime, the foreigner could always charge a low enough price (assuming its own pockets are deep enough) to eliminate domestic firms' profits, but this is clearly not so with a quota -- the worst that can be done is to sell its entire permitted exports, which would not normally be enough to ruin the domestic firms.

Thus, Rotemberg and Saloner (1989) conclude that competitive behaviour is more likely with a quota than a tariff, and cite evidence of Feenstra (1985) that the restraints on Japanese auto exports to the U.S. market resulted in lower quality-adjusted real prices of both Japanese and American autos. That is, though both quality and sticker price increased, quality increased more.

A similar outcome, from a standard conjectural variations model (as in equation (1)) is reached by Rodrik (1988a), developing earlier theoretical work by Buffie and Spiller (1986), in his analysis of the impact of import quota relaxation in three Turkish industries. With scale economies and free entry, relaxing the quota leads to higher domestic prices, in all but fully collusive oligopoly pricing scenarios. The reason is that increased imports force rationalisation on the domestic industry, which results in a "tighter" oligopoly able to charge a higher price. Thus, consumers can lose from this form of trade liberalisation, even though the economy as a whole can be expected to gain, if only because of the recapturing of rents embedded in the higher supply price of imports that is permitted by a quota. Rodrik's results are particularly interesting because they relate to the issue raised above in section 2.4, of the impact on domestic oligopolies' behaviour of free trade-induced structural rationalisation.

In summary, the small literature on oligopolies and quantitative trade restraints yields no consensus as to the likely direction of the linkage between restraints and market behaviour. Clearly, this is a fruitful field for further research.

5.0 CONCLUSION

Can trade policy -- in particular, the Canada/U.S. Free Trade Agreement -- act as a substitute for competition policy? An important and influential body of economic thinking in Canada, beginning with the work of Eastman and Stykolt in the 1960s, and culminating in the quantitative general equilibrium modelling project of Harris and Cox (1984), implies that it can. Specifically, cuts in import tariffs should, according to this school of thought, result in substantial matching cuts in domestic output prices, thereby achieving a primary goal of orthodox structural competition policy.

Other theoretical models do not predict such a strong price impact of free trade. Indeed, under the still-standard "neoclassical general equilibrium" approach, reductions in import prices have absolutely no direct impact on domestic output prices, and in some models in which scale economies are important, tariff reductions are predicted to actually increase domestic output prices.

What about the evidence? Being responsible for much of the Canadian empirical evidence on pricing and the tariff, I have to admit that the picture painted by the data is not yet clear-cut. However, there is support for the proposition that the tariff does affect domestic output price, and that it tends to do so especially in relatively highly concentrated industries, as predicted by Eastman and Stykolt. Furthermore, the finding that concentration variables and tariff protection each fail to show an independent relationship with profitability in Canada, if robust, implies that tariff changes and structural competition policy are in fact neatly substitutable, in the sense that they have no effect on pricing except through their interaction. That is, reducing concentration will only reduce prices in high-tariff industries, and reducing tariffs will only affect prices if concentration is high. Reducing either is sufficient to eradicate the price-raising tendency of the other.

However, at least five qualifications should be added to any proposition that the FTA will do the job of the Bureau of Competition Policy. First, the FTA deals mainly with traded manufactured commodities, and cannot be expect to much influence market behaviour in services, in industries producing commodities (such as concrete or bread) which are naturally protected by transportation costs, or in a number of important agricultural industries presently cosseted by marketing boards and other restrictive practices that were not eliminated by the FTA.

Second, free trade is a once-for-all event. Once it is fully implemented, tendencies towards monopolisation will no longer be constrained by added import competition. And if the process of adjustment to free trade involves the "rationalisation" of North American industries into a smaller number of larger firms, the need for (and also the difficulties of) independent competition policy may become more, not less acute.

Third, this analysis has focused -- as does much industrial organisation analysis -- on the price-setting dimension of competition. Other important performance aspects, such as product variety, have not been approached here, though to the extent that rationalisation reduces the number of brands available, the consumer welfare-enhancing effects of lower prices will be diluted; perhaps, even, reversed.

Fourth, whereas the normative benchmark of competition policy is perfect competition, with all its desirable attributes, the benchmark of the Free Trade Agreement is industrial performance in the United States. To the extent that this falls below ideal standards (say, the standards of Japanese manufacturers), a policy which pushes Canadian industries to match U.S. performance may also fall short.

Finally, unless we accept whole-heartedly the full-blown productivity effects predicted by the Eastman-Stykolt-Harris model, we cannot be sure that, in general equilibrium, tariffs will reduce prices in every industry. If the FTA does not have a large effect on productivity (and thus on the supply price of Canadian exports), then the boost in demand for imports due to elimination of tariffs will need to be countered by a depreciation of the Canadian dollar, to maintain trade balance. The net effect will be an increase in the protection afforded any industry with pre-free trade tariffs lower than the depreciation of the currency, especially if these industries benefit from cheaper input prices after the FTA comes into effect.

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Chapter 6

LEGISLATION TO CONTROL AGREEMENTS IN RESTRAINT OF TRADE IN CANADA: REVIEW OF THE HISTORICAL RECORD AND PROPOSALS FOR REFORM

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1.0 INTRODUCTION

In May 1889 the Parliament of Canada passed "An Act for the Prevention and Suppression of Combinations formed in restraint of Trade."[1] The entire text was less than a page in length and it addressed only the problem of conspiracies in restraint of trade, notably agreements to fix prices or limit output (see Appendix A). Thus Canada enacted its first anti-combines (or antitrust) legislation a year before the United States passed the vastly more famous *Sherman Act* in 1890 (see Letwin, 1965). With remarkably few, but rather important, changes, the Act of 1889 remains at the core of Canadian competition policy legislation, now enshrined in the *Competition Act*,[2] a century later.

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[1] Generally, see Ball (1934); Gosse (1962); Gorecki and Stanbury (1984).

[2] R.S.C. 1985 c. C-34 as amended. This Act amended and renamed the *Combines Investigation Act* in June 1986. See Stanbury (1986b). Effective December 12, 1988 the sections number of the Act were changed. For example, the main conspiracy section, S. 32, became S. 45; S. 32.2, bid-rigging, became S. 47.

For most of its history, competition policy in Canada has been dominated by the enforcement of the conspiracy provisions.[3] For example, from 1889 to 1910 only conspiracies were addressed in Canadian antitrust law. While certain mergers were made illegal in 1910, the first merger case was not decided until 1935.[4] While provisions to deal with monopoly were enacted in 1935, the first case was not decided until 1952.[5] In 1935 Canada enacted legislation making price discrimination and predatory pricing a criminal offence - a year before the U.S. *Robinson-Patman Act*. However, the first cases were not prosecuted until 1957 (Dunlop, 1979).[6] While the U.S. successfully used the *Sherman Act* against single-firm resale price maintenance,[7] Canada did not ban single firm RPM (or refusal to deal) until December 1951.[8] Even then, the number of RPM/refusal to deal prosecutions was small until the 1960s. (See Table 1.) The result is that between 1889 and 1951 conspiracy cases accounted for 80% of all combines prosecutions in Canada. It was not until the mid-1970s that conspiracy cases began to be outnumbered by RPM cases. See Table 1.[9]

The centenary of a policy is a logical point at which to look backward and to look forward. By studying the past we can learn some lessons that should be useful in shaping the future, even in what is a highly dynamic world.

This paper has two main foci. The first is an analytical and empirical review of the conspiracy provisions of Canada's competition legislation over the past century in Section 2. My approach centres on the central characteristics of the legislation and its enforcement outcomes rather than on the evolution of judicial doctrine.[10] The second foci of this paper is to propose a set of changes in the law and policy relating to the conspiracy provisions in light of a century of experience. The heart of these reforms is the suggestion that Canada, like the U.S., declare certain types of agreements to be illegal *per se* while making others subject to a "rule of reason," perhaps by retaining the word "unduly" with respect to them. Section 3 examines the importance of the qualifying word unduly which has been in the Canadian conspiracy provisions for past century. Section 4 makes the case for moving to a bifurcated approach to conspiracies in restraint of trade and reviews the previous efforts to change the statute along these lines. In light of the challenges to the constitutionality in 1990 and 1991,[11] such changes take on new importance. Section 5 proposes that a new civil reviewable provision be enacted to deal with conscious parallelism that produces supra-competitive prices through the use of "facilitating practices." Section 6 contains three sets of reforms in the area of more effective penalties and remedies, civil actions to reinforce public prosecutions, and procedural issues.[12] Finally, the conclusions are set out in Section 7.

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[3] The Director of Investigation states that "conspiracy and bid-rigging activities have accounted for roughly one-third of the Bureau of Competition Policy's workload since the 1960s, a situation that is likely to continue well into the 1990s" (Wetston, 1990, p. 6). Seven major investigations were underway in November 1990 (Wetston, 1990, p. 7).

[4] *R. v. Canadian Import Co. et al.* (1933) 61 C.C.C. 114 (Trial); (1935) 62 C.C.C. 342. The company was found not guilty on the merger count, but was convicted of conspiracy. The second merger prosecution was also unsuccessful. See *R. v. Staples et al.* (1940) 74 C.C.C. 178. The next two merger cases were not brought until 1960; they too were unsuccessful - see MacCrimmon and Stanbury (1978).

[5] *R. v. Eddy Match Co. Ltd. et al.* (1952) 104 C.C.C. 39 (Trial); (1954) 109 C.C.C. 1 (Appeal) (Leave to appeal to SCC denied). Generally, see Stanbury (1978).

[6] Posner (1970, p. 370, n. 9) reports that between 1936 and 1949 some 275 cases were brought under the *Robinson-Patman Act*. From 1950 to 1969 some 940 cases were filed. Other cases were brought under the *Sherman Act*: 123 from 1890 to 1969 (Posner, 1970, Table 23).

[7] See Seligman and Love (1932). Posner (1970, Table 23) reports 27 RPM cases between 1890 and 1969.

[8] See Hunter (1991) and Canada (1952).

[9] Table 1 excludes misleading advertising and deceptive marketing practices cases which grew rapidly from 13 between 1960/61 and 1964/65 to 62 between 1965/66 to 1969/70 to 416 from 1970/71 to 1974/75 (see Gorecki and Stanbury, 1984, Table 3B). In the 1970s, the Bureau averaged 15 cases p.a.; in the 1980s, the average rose to 143 - see Martin (1991, Table 3).

2.0 REVIEW OF THE CONSPIRACY PROVISIONS, 1889-1988

2.01 Initial Fatal Flaw

The Act of 1889 was fatally flawed in that it was a misdemeanour to conspire, combine, agree or arrange "unlawfully" to... "unduly prevent or lessen competition in the production, manufacture, purchase,... sale... or supply of any article or commodity" (see Appendix A). The word "unlawfully" was inserted because some of the supporters of the legislation (including the Minister of Justice) believed that the Act - as the preamble stated - was merely declaratory of the common law (Gorecki and Stanbury, 1984, pp. 108-112). This was erroneous (Gosse, 1962) and the original legislation was unenforceable[13] until the word "unlawfully" was removed in 1900 - see Appendix A, Baggaley (1991), and Gorecki and Stanbury (1991).

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[10] That task is done is some papers such as Sommerfeld (1948), Quinlan (1966a) (1966b), Nozick (1979) (1985), Webber (1982), Stanbury et al. (1984), Dunlop et al. (1987), Stanbury (1989b), Cairns (1981), Engelhart (1981), McFetridge and Wong (1982a) (1982b), Stanbury and Reschenthaler (1977), Brecher (1960), Gosse (1962), Kaiser (1982), Magwood (1981), Wahn (1945a) (1945b).

[11] See Facey and Stanbury (1991), Ross (1991), and Hunter (1990b).

[12] I do not address the need to reform the exemption for export agreements nor the problem of enforcing the conspiracy provisions in light of the increasing "globalization" of economic activity. These matters are addressed by Julian Chipman in Part 2 of this volume.

[13] See *R. v. American Tobacco Co. of Canada* (1897) 3 *Rev. de. Jur.* 453; and the discussion in Ball (1934).

2.02 Unduly

The qualifying word "unduly," except for one year (1889), has remained in the conspiracy provisions - and greatly weakened them - to this day.[14] It is this one word which so radically distinguishes the Canadian law from S.1 of the *Sherman Act* which clearly and simply stated that

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared illegal shall be deemed guilty of a felony...

The substantive text of both S.1 and S.2 of the *Sherman Act* has not been changed to this day. While the courts in the U.S. developed a two-pronged approach to conspiracies, declaring a number of them including "bare cartels" to be illegal *per se*, while judging others by the "rule of reason,"[15] in Canada the courts have never failed to give even "naked" price-fixing agreements the benefit of the qualifying word unduly.

As is documented more fully in Section 3, the word "unduly" has been responsible for more than one-half the acquittals in conspiracy cases over the past century (excluding decisions based on procedural matters). While there have been several attempts (notably in 1971 and 1981) to eliminate the word, and to make at least some types of horizontal agreements (e.g., "bare cartels") illegal *per se*, the business community - aided by the Canadian Bar Association - has fought them off.[16] See Section 4 below.

2.03 Parallel Provisions

Between 1910 and 1960 Canada had two parallel provisions dealing with conspiracies in restraint of trade. The Act of 1889 was incorporated into the *Criminal Code* in 1892 where it remained virtually unchanged until 1960 (with the notable amendment in 1900). The *Combines Investigation Act* of 1910 was designed to provide a better method of enforcing the law against "combines," but it also provided a new, more expansive definition of a combine (which also included a merger). The critical distinction was that under the *Act* the Crown had to prove that a conspiracy had operated or was likely to operate to the detriment of the public, whether producers, consumers, or others (see Appendix A). Under the *Criminal Code*, the Crown had to prove that a conspiracy prevented or lessened competition unduly, or was likely to do so. As Tables 3 to 5 make clear, with the exception of the period 1923-1942 when most cases were brought under both laws, virtually all conspiracy cases were brought under the *Criminal Code* prior to 1960. In 1960, the *Code* version, with some minor changes, were incorporated into the *Combines Investigation Act*. They remain in the present *Competition Act* (see Appendix A).

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[14] The evolution of the conspiracy provisions since 1889 can be found in Appendix A.

[15] See, for example, Sullivan (1977); Von Kalinowski (1982); Areeda (1986); Areeda and Turner (1978); Bork (1966), (1978); Ross (1991).

[16] The response to Bill C-256 in 1971 is discussed in Stanbury (1977); the response to the Minister of Consumer and Corporate Affairs reform proposals in 1981 is discussed in Stanbury and Reschenthaler (1981). The Bar Association's support for unduly can be seen in its briefs on proposed changes in the legislation.

In practical terms, the parallel provisions for 50 years were of little consequence. Almost all judges treated "unduly" and "public detriment" as synonymous.[17]

2.04 Only Criminal Law

Over the entire century the only method of dealing with conspiracy cases in Canada has been by criminal prosecution almost always seeking a fine as the sole remedy. For constitutional reasons[18] there has been no provision, as there is in the U.S., to seek a civil consent judgment[19] which results in an injunction.[20] Those accused of agreeing to fix prices cannot plead *nolo contendere* to criminal charges in Canada. Since 1952 in Canada, the Crown has been able to seek a prohibition order as the sole remedy in all criminal antitrust cases. As is documented in Table 6, the Crown has made increasing use of this form of action in conspiracy cases since the 1960s. From the defendants' perspective, the "P.O. only" or Prohibition Order Without conviction route (POWC) is somewhat like a consent order in the U.S. They need not plead guilty, but only agree (after negotiations) with the statement of facts submitted to the Court by the Crown. Because such proceedings are very rarely contested, the usual result is swift Court approval of the Order as drafted by the Crown (through negotiations with the defendants). Because the defendants do not plead guilty and a "P.O. only" is not a conviction, the Order does not constitute *prima facie* evidence of a violation of the Act for the purpose of a private civil action under S.36 of the *Competition Act* (formerly numbered as S.31.1).

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[17] See *R. v. Clarke* (1907) 1 Alta L.R. 358 at p. 368; *Weidman v. Shragge* (1912) 46 S.C.R. 1 at p. 25; *R. v. Alexander* (1932) 2 D.L.R. 109; *R. v. Canadian Import* (1935) 62 C.C.C. 342; *R. v. Canadian Breweries* (1960) O.R. 601. But see *R. v. Morrey et al.* (1956) 115 C.C.C. 227.

[18] See McDonald (1965) and Rutherford and Tyhurst (1991).

[19] Posner (1970, Tables 1, 5, 15) notes that of the 1551 antitrust cases filed by the U.S. Department of Justice between 1890 and 1969 (of which 1106 were conspiracy cases), 857 were civil cases. Of these 530 were decided in favour of the government and 76% of this number consisted of consent judgments.

[20] Note that the civil remedy under the *Sherman Act* is very important because the equity powers of the courts in civil proceedings are practically unlimited. Von Kalinowski (1982, para. 1.02[1]) notes that under S.1 of the *Sherman Act* "criminal enforcement is reserved for the most serious and flagrant violations." It has been Department of Justice policy to institute criminal proceedings only in the case of wilful violations of the law and if the rules of law alleged to have been violated are clear and established, e.g., *per se* offences.

2.05 No Private Enforcement

The enforcement of the law in Canada against agreements in restraint of trade did not have the benefit of private enforcement prior to 1976 (see McDonald, 1979; and Strekaf in Part 9 of this volume). In contrast, the *Sherman Act* in 1890 provided for the aware of treble damages to private plaintiffs as well as costs including reasonable attorney fees. As a result, private actions are numerous and greatly reinforce public enforcement. In Canada, private plaintiffs are limited to single damages[21] and they also face cost rules that reduce the incentive to sue (Prichard, 1979).

In the U.S., Posner (1970, Table 3) estimates that from 1890 to 1969 over 9700 private antitrust actions were initiated and between 1890 and 1963, some 759 of the 880 reported private antitrust cases between 1890 and 1963 were preceded by a judgement in a case filed by the Department of Justice.[22] Salop and White (1988, p. 4) indicate that the U.S. government filed 2789 antitrust cases of all types between 1941 and 1984. During the same period, 28,509 private antitrust actions were filed. The U.S. General Accounting Office (1990, p. 18) indicates that between 1980 and 1989 the U.S. Department of Justice launched 998 antitrust actions; during the same period there were 10,018 private antitrust cases, although the number declined from 1457 in 1980 to 638 in 1989. See Latimer, Table 1 in Part 9 of this volume. Even allowing for the fact that a minority of such actions get to court, the important role of private enforcement in the U.S. is obvious (see White, 1988; Kellman, 1985).

It should be noted that, because of the restrictiveness of the rules of court, there has never been a class action antitrust case in Canada,[23] while in the U.S. such a form of private action is quite common.[24] There is also no provision for *parens patriae* actions in Canada.[25] Even with the amendment effective in 1976, very few private civil actions have been launched (see Strekaf in Part 9 of this volume). The reasons for this are discussed in Section 6.2 below.

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[21] A provision for double damages was proposed in 1971, but it was widely opposed by business. See Canada (1971), Stanbury (1977).

[22] The huge difference between 9700 and 880 is accounted for by (a) differences between number of reported cases and estimated total private cases, and (b) the explosion of private cases from 1964 to 1969, largely due to the electrical equipment cases.

[23] In 1977 the federal government in Bill C-42 proposed that class and "substitute" (analogous to *parens patriae*) actions be permitted with respect to competition policy cases. See Reid (1978), Prichard (1979), McDonald (1979). Business opposition defeated both proposals (see Stanbury, 1979b).

[24] In 1966 Rule 23 of the Federal Rules of Civil Procedure was amended and one of the effects was to broaden the scope of class actions in the antitrust area. A set of five criteria must be met before a court will certify a class action. Since this amendment, "a prodigious number of antitrust class actions, some quite massive, have been filed" (Von Kalinowski, 1982, para 8.07[2]).

2.06 Few Prosecutions Compared to U.S.

The number of conspiracy prosecutions in Canada has been tiny compared to the U.S. as the data in Table 2 attest. Between 1890 and 1969 the U.S. Department of Justice filed 989 conspiracy cases and from 1915 to 1969 the Federal Trade Commission filed another 290. The combined total amounted to 18.3 times the Canadian total of 70 cases during the period 1889-1969. Over the past century in Canada, a total of 138 conspiracy cases have been completed (Table 6). In some periods there were no prosecutions or only one or two. For example, from 1889 to 1902 only one case was prosecuted in Canada. From 1903 to 1910 the number increased to eight (see Table 3), but this was only one-quarter the rate in the U.S. - see Table 2. From 1911 to 1923 only one conspiracy case was brought in Canada - and it was unsuccessful despite the abundance of documentary and oral evidence of elaborate agreements between grocery wholesalers and manufacturers.[26] In contrast, in the U.S., from 1910 to 1924 the Department of Justice brought 91 conspiracy cases and the FTC brought another 11 (Table 2). Under the better enforcement apparatus embodied in the *Combines Investigation Act* of 1923, there were more prosecutions: 13 begun prior to W.W.II, and the Crown had a high success rate - see Table 3. The number was still a tiny fraction of conspiracy prosecutions in the U.S. as Table 2 indicates. The number of conspiracy cases in Canada grew after the war; between 1949 and 1964 there were 27, 18 of which were completed in the 1950s - see Table 4. The average number of cases per year almost doubled between 1965/66 and 1990/91: some 89 in 25 years[27] - see Table 5.

Why have so few conspiracy cases been prosecuted in Canada in comparison to the U.S.. The ratio - about 18 to 1 - is almost twice the relative size of the two economies. We should not expect, however, that the number of potential price-fixing or market-sharing conspiracies to be proportionate to the scale of the economy measured by GNP. Both Canada and the U.S. are industrialized economies whose composition of output is quite similar. (The foreign trade sector is, of course, a much larger proportion of the Canadian economy.)

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[25] Under the *Hart-Scott-Rodino Antitrust Improvements Act* of 1976 (which amended S. 4C-H of the *Clayton Act*) state attorneys general are empowered to bring treble damage actions as *parens patriae* on behalf of resident natural persons injured in their property by reason of any *Sherman Act* violation.

[26] *A.G. of Ontario v. Canadian Wholesale Grocers Assoc.* (1922) 52 O.L.R. 536 (Trial); (1922) 53 O.L.R. 627 (Appeal). Essentially the same arrangements existed more than a decade earlier, but they too were acquitted. See *R. v. Beckett et al.* (1910) 15 C.C.C. 408. This cartel existed on and off since 1884 (see Bliss, 1974).

[27] The U.S. General Accounting Office (1990, pp. 43, 44) indicates that of the 571 criminal antitrust cases filed by the U.S. Department of Justice between fiscal years 1982 and 1988, 521 were restraint of trade cases of which over one-half (55%) were price-fixing or bid-rigging cases. In fiscal years 1970-76, 1977-1980 and 1981-1989, the average number of civil restraint of trade cases was 19 p.a., 17 and 6 respectively - out of a total of 48 p.a., 30 and 13 civil cases.

Where the industrial structure of two countries is quite similar, we should expect to find a similar absolute number of price fixing agreements, *ceteris paribus*. But some other factors might well influence the underlying number of such agreements. First, there is the level of concentration in the many markets that make up an economy. With high levels of concentration in the relevant markets, one would expect fewer overt agreements on price, market shares and the like because the firms find it easier to coordinate their behaviour to achieve supra-competitive prices without an illegal agreement (Howard and Stanbury, 1990). Market concentration is substantially higher in Canada than the U.S. (see Marfels, 1988; Khemani, 1971). Therefore, one might expect somewhat fewer conspiracy prosecutions in Canada than the U.S.. Second, a country's geographic distribution of population and transportation costs could result in more local or regional markets and fewer nation-wide ones. The result is more identifiable product/geographic markets (particularly if there are also notable tariff barriers - as was the case in Canada prior to the Free Trade Agreement with the U.S. beginning in 1989). More markets, *ceteris paribus*, should lead to more potential agreements among competitors - subject of course to the point about highly concentrated markets.

Third, it might be argued that Canadians are more or less law abiding than Americans, hence there will be fewer or more illegal agreements. It is impossible to say, although one can point to a lower rate of violent crime in Canada even adjusted for size of city. Further, there is more evidence suggesting that Canadians have a greater cultural pre-disposition against the virtues of aggressive competition that are more highly valued by Americans. Canadians not only tolerate many more private and government-imposed restraints on trade - they welcome them (see Gorecki and Stanbury, 1991). The word "unduly" did not get into the law in 1889 by chance.[28] Nor has it stayed there merely by inertia.[29] It reflects a deep-seated pattern of beliefs that only demonstrated abuses of individual or collective market power should be constrained.[30] In other words, it is acceptable to fix prices and enhance prices, so long as competition is not lessened "inordinately" or prices are not increased by an "unreasonable" amount. Recall that from 1910 to 1960 the *Combines Investigation Act* only condemned those combinations that were held beyond a reasonable doubt to have operated to the detriment of the public, whether consumers, producers, or others.[31]

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[28] See Gosse (1962), Gorecki and Stanbury (1984), Baggaley (1991).

[29] See the discussion in Section 4.2.

[30] See King (1911) (1912), Ball (1934), Reynolds (1940), Gorecki and Stanbury (1984), Skeoch (1966).

Finally, we might speculate that the vast difference in the number of conspiracy prosecutions between Canada and the U.S. is attributable to the existence of "unduly" and "unreasonably" in the Canadian law. Canadian investigators and prosecutors may simply have screened out many other cases where they believed that there was a high probability the courts would hold that while there was agreement, it had not lessened competition unduly or enhanced prices unreasonably. Table 2 indicates that between 1924 and 1940 some 17 combines reports were sent to the Attorney General but were not prosecuted.[32] In the post-W.W.II period 112 cases were referred, but not prosecuted, but this number would include some cases that were not conspiracies. In more recent years, between 1960/61 and 1990-91 at least 24 conspiracy cases were referred to the federal Attorney General, but were not prosecuted - see Table 6.

2.07 Variety of Approaches to Enforcement

In stark contrast to the U.S., Canada has "experimented" with seven different sets of institutional arrangements to enforce its competition laws. See Figure 1 and Gorecki and Stanbury (1991). In the U.S. the enforcement of the *Sherman Act* was delegated to the federal Attorney General in 1890. In 1905 the first separate appropriation was made for antitrust work and an Assistant Attorney General for Antitrust was appointed (Weaver, 1977). It has never been changed.[33] The point is that Canada did not have a viable administrative structure for enforcing its competition legislation until 1923. But even then, the design included several "filters" between the person responsible for investigation and actual prosecution (see Gorecki and Stanbury, 1991). However, it was not until the early 1960s that the delaying "filter" of the separate "appraisal and public report" phase was abandoned. Even to this day, however, the permanent official responsible for enforcement, the Director of Investigation and Research, cannot - unlike his U.S. counterpart - prosecute even the simplest price-fixing case on his own initiative. All prosecutions remain the exclusive authority of the federal Department of Justice. Tables 1 and 6 provide some indication of the number of conspiracy cases referred by the DIR to Justice which were not prosecuted.

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[31] Note that when it was put in the legislation the word "producers" referred to both manufacturers or distributors and to farmers. It was the *Criminal Code* provisions which used the word "unduly" and "unreasonably." See Appendix A.

[32] Gorecki and Stanbury (1991, Table 10) report that between 1923 and 1952 there were eight reports by the Registrar/Commissioner or a Special Commissioner which found there was a combine, which were referred to a provincial or to the federal Attorney General, but which were not prosecuted.

[33] As the data in Table 2 indicate, the Federal Trade Commission, since it was created in 1915, can also enforce the *Sherman Act* (as well as the *FTC Act* and *Clayton Act*). The DOJ has shared jurisdiction over mergers with the FTC since the 1950 amendments made the *Clayton Act* operational.

2.08 Modest Fines

By far the most common penalty or remedy in conspiracy cases in Canada has been the fine, and since 1952 the fine and Prohibition Order.[34] See Tables 3, 4 and 5. The fines actually imposed in conspiracy cases were aptly described by Mr. Justice Rand, writing over three decades ago: "[T]he procedure of enforcement by conviction and fine had tended to exhibit a course of things bearing a close likeness to periodic licensing of illegality."[35] He went on to warn that unless sanctions under the Act were made more effective they would enable "self-confessed lawlessness to set the will of Parliament at defiance."[36]

Between 1889 and 1952 the maximum fine for corporations convicted in conspiracy cases under the *Criminal Code* was $10,000.[37] Between 1952 and 1975 the size of the fine was at the discretion of the court (see Stanbury, 1976). A maximum $1 million fine was put into effect January 1, 1976, in the words of the then Minister of Consumer and Corporate Affairs, "to give the judges something to shoot at." In June 1986 the maximum fine for a violation of S.45 (previously numbered S.32) was increased from $1 million to $10 million in the new *Competition Act*. Note that it was at the Committee stage that the maximum fine was increased from $5 million in Bill C-91 to $10 million (Stanbury, 1986).

To the end of fiscal 1990/91, the largest fine imposed on a single firm in a conspiracy or bid-rigging case was $1,000.000. Three flour millers were each fined this amount after pleading guilty to bid-rigging in December 1990.[38] The previous record for a bid-rigging case occurred in 1988 when three firms were each fined $400,000 (Hunter, 1988c). The largest fine in a conspiracy case (S.32, now S.45) was $400,000 levied on Mediacom Inc. in February, 1985.[39] Previously, the largest fine was $300,000 imposed on Canadian General Electric in 1976[40] and before that it was $125,000 imposed in 1974.[41] To put these figures in perspective, note that the largest fine in a misleading advertising case is $1 million, imposed on Simpson-Sears Ltd. in 1985 (Martin, 1991) and the largest fine for a single count of resale price maintenance is $200,000 in 1990.[42]

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[34] For a discussion of the entire range of potential penalties and remedies, which include removal of tariff protection and cancellation of intellectual property rights, see Stanbury (1976).

[35] *Goodyear Tire and Rubber Co. of Canada Ltd. v. The Queen* (1956), 2 D.L.R. (2d) 11 at p. 13, 114 C.C.C. 380 at p. 382 (C.C.C.).

[36] *Ibid.*

[37] For individuals, the maximum fine was $4000 from 1889 to 1952 when it was at the discretion of the court. Under the *Combines Investigation Act* the maximum fine was $1000 per day from 1910 to 1919. From 1923 to 1952, it was $25,000. In 1952 it became at the discretion of the court. Almost all conspiracy prosecutions during this period were brought under the Criminal Code although similar provisions were contained in the Combines Investigation Act between 1910 and 1960. In 1960 the two versions were consolidated in s.32 of the Act. Note that in the U.S. the maximum fine under the *Sherman Act* from 1890 to 1955 was only $5000 when it was raised to $50,000. In 1974 it was raised to $1 million for corporations and $100,000 for individuals. The maximum for individuals was raised to $250,000 in 1985 (Werden and Simon, 1987).

Average fines in conspiracy cases, however, have been much lower as the data in Table 7 indicate.[43] In nominal dollars, the average fine per case increased from $5,756 between 1889 and 1910 to $58,700 in the early 1950s where it stayed (roughly) through the 1960s. Then it increased to almost $97,000 in the early 1970s and increased by more than five times to $565,500 in the late 1980s. During fiscal years 1984 and 1985, the average fine in U.S. conspiracy cases was $132,700 per firm and $23,132 per individual (Werden and Simon, 1987, p. 927).[44]

In general, the average number of defendants (individuals and corporations) convicted[45] per case declined since the early 1970s. For example, the average between 1889 and 1910 was 8.6 and it was 9.7 between 1924 and 1942. However, since the early 1970s the average number of defendants per conspiracy case (per five-year period) has ranged from 3.5 to 5.7. See Table 7. Between 1975 and 1980 the average number of defendants in U.S. conspiracy cases was three individuals and five corporations (Werden and Simon, 1987, p. 927).

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[38] "3 mills each fined $1 million," *Globe and Mail*, December 8, 1990, pp. A1, A5. See also *Financial Post*, December 10, 1990, pp. 1, 16.

[39] (1985) 3 C.P.R. (3d) 47 (Ont. HCJ). See *Annual Report, Director of Investigation and Research, Combines Investigation Act, for the year ended March 31, 1985* (Ottawa, Minister of Supply and Services, 1985), p. 46.

[40] *R. v. Canadian General Electric Co. Ltd.* (1977) 35 C.P.R. (2d) 210, 2 B.L.R. 230 (Ont. H.C.J.) (sentence).

[41] *R. v. Ocean Construction Supplies Ltd. et al.* (1974) 15 C.P.R. (2d) 224 (Sentence); upheld (1974) 22 C.C.C. (2d) 340.

[42] "Shell Canada Fine Increased," *Canadian Competition Policy Record*, Vol. 11(1), 1990, pp. 2-3.

[43] The data in Table 7 include both conspiracy and bid-rigging cases. The latter became a separate offence effective January 1, 1976. Unlike ordinary conspiracies to fix prices, bid-rigging is illegal *per se*. The Crown need not prove that competition has been lessened unduly.

[44] In the U.S., the total fines levied on corporations in conspiracy cases tripled over the decade ending in 1989 to $25.6 million. In 1989, corporate officials served a total of 7,743 days in jail - more than five times the level a decade earlier (*Globe and Mail*, December 17, 1990, p. B2).

[45] In a substantial percentage of cases more firms (and/or individuals) were charged than convicted. The difference is largely accounted for by the Crown dropping charges rather than acquittals.

Posner's (1970) data for the U.S., reported in Table 1, indicate that the average fine per case under the *Sherman Act* between 1924 and 1942, for example, was twice the level as in Canada - despite the ceiling of $5000 on fines up to mid-1955. However, the average number of defendants per case appears to have been higher in the U.S..[46]

In the early 1950s the average fine per conspiracy case in Canada was over three times the U.S. level (both in nominal dollars), but was quite comparable in the mid to late-1950s (see Tables 1 and 7). In the early 1960s, after the U.S. maximum had been increased to $50,000 and there was no maximum in Canada, the average fine per case in the U.S. was 2.5 times that in Canada.

On a per defendant (firm or individual) basis, average fines have increased greatly over the century of conspiracy and bid-rigging cases, e.g., from $576 between 1889 and 1910 to $11,252 in the early 1960s, to $125,667 in the late 1980s - see Table 7. In constant dollars, however, the increase is much less. Between 1900 and 1988 the Consumer Price Index (1981 = 100) rose from 8.5 to 143.8 or 16.9 times.[47] Thus an average fine of $125,667 in the late 1980s is roughly equivalent to a fine of $7,436 in 1900. Even if we compare the average fine per firm in the early 1960s ($11,252) to those in the early 1980s ($69,234) we find that in constant 1981 dollars the increase was much less: from $35,163 to $59,064. In both cases, it is likely that the firms or individuals' legal fees were greater than the fine. However, the latter are tax deductible for firms while fines must be paid from after-tax dollars.

For the three bid-rigging[48] cases in the early 1980s, the average fine per case was $35,167 and the average per firm was $11,722. However, between 1985/86 and 1990/91 the seven successful cases resulted in average fines of $805,000 per case and $234,792 per firm[49] convicted. The sharp increase is attributable to the two business forms cases (Hunter, 1988c, p. 2) and the flour milling case in which seven defendants were fined a total of $3,405,000 and the other received a Prohibition Order without conviction.[50]

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[46] Posner (1970, Table 25) states that almost two-thirds of U.S. conspiracy cases between 1890 and 1969 involved 10 or fewer conspirators; over one-third had five or fewer conspirators; however, almost one-sixth had 21 or more.

[47] Data from Stanbury (1976) and Statistics Canada Cat. No. 11-210 (July 1989).

[48] From January 1, 1976 to December 12, 1988 it was S. 32.2. Then it became S. 47. Recall note 43.

[49] This calculation is based on eight defendants in the flour milling case, although one received only a Prohibition Order without conviction.

Table 6 indicates that in conspiracy and bid-rigging cases since 1952 in which a conviction was obtained, the court imposed a Prohibition Order in addition to the traditional fine in 62 cases and in 14 the result was a fine alone.

2.09 POWC Cases

An Order of Prohibition as the sole remedy was the result of an amendment to the *Combines Investigation Act* in 1952. It was not used in a conspiracy case until the 1960s - see Table 6. Between 1960/61 and 1988/89 the Crown has made use of this option in 19 of 100 cases. Only one of the 19 applications to the courts for a Prohibition Order without conviction (POWC) was contested (see #34 in Table 5). The point is that this approach usually amounts to a "soft" remedy, although the industry-wide order obtained against all 114 local real estate boards in Canada in December 1988 has enormous reach (see Hunter, 1988d; Stanbury, 1989c). Indeed, it should be described as "regulatory" in the sense that the Federal Trade Commission makes industry-wide rules in the U.S..

The 18 POWCs between 1960/61 and 1988/89 amount to 24% of all conspiracy cases in which the Crown was successful. On the other hand, a review of the cases (Tables 4, 5) indicates that many more detailed orders have been issued beginning in the 1960s.[51] Whether they are, in fact, being abided by is extremely difficult to determine. However, most of the recent orders provide for the firms and individuals bound by them to provide the Director of Investigation and Research with information that would assist him in monitoring their behaviour. Even with 37 years of experience with POWCs, no contempt charge has been brought stemming from a failure to abide by the terms of an Order.[52] Is this because everyone complies or because the Bureau of Competition Policy is unable to monitor the growing number of orders properly?

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[50] Information provided by Bureau of Competition Policy.

[51] See, for example, Hunter (1988b). For an earlier discussion see Gorecki and Stanbury (1979).

[52] In September 1990 the Director filed a statement of claim in the Federal Court of Canada against the Canadian Real Estate Association seeking an order requiring CREA to expel the Winnipeg Real Estate Board from CREA for failure to abide by the Prohibition Order of December 1988. See *Globe and Mail*, October 6, 1990, p. B3. The Court dismissed the action on January 28, 1991 by Rouleau, J. on the grounds that the statement of claim failed to disclose any cause of action against CREA or the Winnipeg Borad.

2.10 Success Rate

For the purpose of this paper a "successful" case is one in which the Crown either obtained a conviction or a "P.O. only" (Prohibition Order without conviction) if it took that route (available since 1952).[53] The success rate is computed excluding cases in which all charges were dropped after an Information was laid or in which a Stay of Proceedings was entered by the Crown. The calculation, therefore, includes cases in which charges were dismissed at a preliminary hearing and the Crown did not prefer an indictment to take the case to trial as well as those which went the trial level or beyond.

The Crown's success rate varied from zero to 100% over the 12 periods into which the century was divided (Table 6). The rate over the entire century was 80%. Posner (1970, Table 11) reports that the U.S. Department of Justice succeeded in 81.4% of all antitrust cases filed between 1890 and 1967. He notes that "since 1910, there has been no five-year period in which the Department did not prevail in at least 64 per cent of the cases it initiated in that period. And its record has been even better since 1925" (Posner, 1970, pp. 381-382).

Over the first 21 years of conspiracy cases in Canada the Crown won 70%, despite the fact that only 10% of the cases involved a plea of guilty. The low guilty plea rate reflects the fact the law was new and defendants wanted to determine how it would be interpreted. The success rate in the U.S. was 56% (Posner, 1970, Table 11). The Crown's success rate increased to 80% in the period 1924 to 1940 and the guilty plea rate doubled to 20%. From 1950/51 to 1969/70 the Crown won 95% of a growing number of conspiracy cases with a guilty plea rate of 60%. This raises the question whether the Crown's success (win) rate was too high. As Posner (1970, p. 383) observes, "The high ratio of wins to losses in government antitrust cases may reflect not a favorable disposition on the part of the Court but merely careful screening by the Solicitor General...." It may also reflect the fact that the Crown is failing to test the limits of the law by bringing cases that require more imaginative approaches.

In any event, the success rate fell dramatically to 58% between 1975/76 and 1984/85. See Table 6. Yet the guilty plea rate was 69%. The point is that if the accused contested the case they almost always won. They won in a majority of cases on the grounds that the agreement did not lessen competition unduly.[54] In others, the court held there was no agreement - see Figure 2.

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[53] Posner (1970, p. 381) counts as a "success" (win) by the Department of Justice those cases resulting in consent judgments (injunctions) and *nolo contendere* pleas.

Over the last six years (1985/86 to 1990/91), the success rate increased to 83%, but this was primarily due to an unusually large number of "P.O. only" (POWC) cases (seven out of a total of 23). Although in 92% of the regular prosecutions the accused pleaded guilty, when they did not they were acquitted.

2.11 Appeal Rate

Of the 145 conspiracy and bid-rigging prosecutions between 1889 and 1990/91 only eight went to the Supreme Court of Canada while another 24 ended at the Court of Appeal (six of these being denied leave to appeal to the nation's highest court). See Table 8. The Supreme Court of Canada upheld convictions in the first five cases it heard, but it acquitted all of the last three conspiracy cases it has heard (*Aetna*, *Atlantic Sugar*, and *Chatwin Motors*).[55] Moreover, in *Aetna* and *Atlantic Sugar* the highest court caused much confusion on several issues which required several amendments in 1986 (Stanbury, 1986).

Another important trend is evident in Table 8. Since the early 1970s, eight (of 78) cases ended at the preliminary hearing level. This had never occurred before in Canada's antitrust history. In five of these cases, the accused were discharged and the Crown did not subsequently prefer an indictment so the matter could be tested at trial in a provincial superior court.

The appeal rate (fraction of cases taken to the Court of Appeal or beyond excluding successful POWC cases) was 48% between 1889 and 1949. Since that time it has fallen dramatically to 17.5% from 1950/51 to 1969/70 and 21.3%[56] between 1970/71 and 1990/91. While the appeal rate fell, the success rate for the accused increased. From 1889 to 1949 the accused succeeded in only two of 12 appeals and in the period 1950/51 to 1969/70 they won in two of eight appeals. However, since 1970/71 the accused's success rate increased to six of 15 cases. In half of these successful appeals the Supreme Court of Canada sided with the accused. The moral of this story is that while relatively few appeals have been launched since the 1970s, the accused's success rate has been quite high (40%) in large part because the

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[54] Testifying in 1986 the previous Director of Investigation and Research mistakenly told the parliamentary committee on Bill C-91 (which became the present *Competition Act*), that the existence of the word unduly did not explain the Crown's low conviction rate in the 1970s. He said it was due largely to the Crown's failure to prove that the accused had formed an illegal agreement. See Statement by Lawson A.W. Hunter, *Minutes of Proceedings of Legislative Committee on Bill C-91*, Issue No. 8, May 13, 1986, p. 8:6.

[55] The full citations and reported judgments can be found in Appendix B.

[56] Calculated as 13 cases ending at Appeal Court, leave denied or SCC level divided by 61 cases (which excludes POWC cases).

Supreme Court of Canada has become highly skeptical of the virtues of the conspiracy provisions (see Stanbury et al., 1985). It remains to be seen, however, if the 1986 amendments will block the appeal courts from interpreting the legislation so favorably to those who fix prices and allocate markets or if the protections in the 1982 *Charter of Rights and Freedoms* will dominate (see Facey and Stanbury, 1991; Ross, 1991; Hunter, 1990b).

3.0 THE IMPORTANCE OF UNDULY

As noted in the previous section, unlike the United States, Canada has never even made "bare cartels" illegal *per se*. From 1889 to the present day, the conspiracy provisions (now S.45 of the *Competition Act*) have made illegal only those agreements that had (or were likely to) lessen competition unduly or to enhance prices unreasonably. Put another way, price fixing is not a criminal offence in Canada unless it is deemed to "go too far," i.e., results in an undue lessening or unreasonable increase in prices. It is permissible, therefore, to conspire to increase prices by a "reasonable" amount. Where the line is to be drawn is left up to the courts as neither term has ever been defined in the legislation. The most frequently quoted "definition" of unduly is that provided in the first successful combines prosecution: "in an undue manner or degree, wrongly, improperly, excessively, inordinately."[57] Much ink has been spilled in combines cases because of this word.[58] More importantly, the word has made even bare cartels morally and legally ambiguous.[59]

In one of the most recent decisions of the Supreme Court of Canada, *Aetna Insurance*, a majority of the court, speaking through Ritchie J., stated that "An accurate assessment of the meaning of unduly as it has been construed in the various cases" was contained in the following words of Hart J. (the trial judge): "What is criminal is an agreement that is intended to lessen competition improperly, inordinately, excessively, oppressively or one intended to have the effect of virtually relieving the conspirators from the influence of free competition."[60] With these words, the highest Court linked together the traditional definition of unduly first enunciated at the turn of the century in *R. v. Elliott*,[61] with Mr. Justice Cartwright's test in *Howard Smith*[62] ("the effect of virtually reliving the conspirators from the influence of competition"). It should be noted that subsequent to *Howard Smith* the courts, including the Supreme Court of Canada in several cases, almost always adopted the definition of unduly provided in *Elliott* rather than Cartwright J.'s test which he enunciated as part of a concurring opinion for a court that upheld the conviction. John Howard (1986, p. 302) argues that Canadian conspiracy cases "are so inconsistent and the multiple opinions often so contradictory and confusing they virtually defy clear analysis or, even worse, they render possible almost any rationalization."[63]

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[57] *R. v. Elliott* (1905) 9 O.L.R. 648 at p. 662. Laskin, J.A. (then of the Ontario Court of Appeal) described this approach as "a mere stringing together of a series of pejorative adjectives or adverbs." *R. v. J.J. Beamish Construction Co. Ltd.* (1967) 65 D.L.R. (2d) 260 at pp. 285-286.

[58] The historical record is the antithesis of what one trial judge said in his charge to the jury in 1932: "I think you probably will not have much trouble with the word unduly! It is a sensible sort of word. Too much is undue, unfair is undue, wrong: you have to consider it as sensible men" (*R. v. White*, Ontario Supreme Court unreported, April 1, 1932). The result was that all 11 were convicted, but a fine of only $100 was imposed plus one year's suspended sentence.

[59] In the constitutional challenge to the conspiracy section, the Trial Court in the Nova Scotia pharmacists case held that the meaning of "unduly" was so vague and uncertain as to deprive the accused of their rights to fundamental justice to make full answer and defence, and to a fair trial under S. 7, 11(a) and 11(d) of the 1982 Charter of Rights and Freedoms. See Hunter (1990b), Facey and Stanbury (1991), and Wetston (1991).

A review of a century's experience with Canada's legislation dealing with price-fixing and other types of horizontal agreements indicates unequivocally that "unduly" matters. It is a myth that the Canadian courts have dealt with conspiracies in much the same way as their U.S. counterparts, despite the obvious difference in the wording of the legislation. In short, Canadian judges have never overlooked the word "unduly," nor have they interpreted it as requiring that the accused account for only a modest fraction of the market. For example, in the *Quebec Insurance Agents*[64] case in 1979, the trial judge found there was an agreement, but acquitted because he found as a matter of fact that the accused had slightly less than 50% of the market and he drew the line at that "magic number" in defining unduly. The fact that the defence thought it useful in the *Abitibi*[65] case decided in 1960 to argue at length that the accused's share of the market was as low as 42.4%, while according to the Crown it was between 56% and 73.8%, is proof that unduly was truly interpreted as "inordinately" or "oppressively' to quote from the synonyms used in a 1905 case.

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[60] *Aetna Insurance Co. and 72 Other Corps. v. The Queen* (1977) 75 D.L.R. (3d) 332 at pp. 344-5.

[61] (1905) 9. O.L.R. 648 at pp. 661-2, 9 C.C.C. 505 at p. 520 (C.A.).

[62] *Howard Smith Paper Mills Ltd. v. The Queen* (1957), 8 D.L.R. (2d) 449 at p. 473, (S.C.C.).

[63] Yet he also argues that unduly should be retained as a "desirable constraint on prosecutorial and judicial adventurism [and] that S.32 [now S. 45] and the cases interpreting it, when analyzed dispassionately, do afford a workable test to deal with conspiracy cases" (Howard, 1986, p. 3.04).

[64] *R. v. La Federation des Courtiers D'Assurance du Quebec* (Unreported decision of the Quebec Superior Court, District of Saguenay, April 20, 1979; Bureau of Competition Policy mimeo 229-1 (unofficial translation); upheld by the Quebec Court of Appeal, March 30, 1982 (unreported).

[65] *R. v. Abitibi Power and Paper Co. Ltd. et al.* (1961) 131 C.C.C. 201.

The previous Director of Investigation and Research has stated that "the qualification of 'unduly' is critical." He noted that the courts have no fixed rule in determining what share of the market the accused must account for before an agreement will be held to lessen competition unduly. "There have been acquittals where the market share was as high as 83 per cent,[66] convictions where it was as low as 56 per cent."[67] In one case at least, *Electrical Contractors*,[68] the market share of the firms who were convicted appears to have been less than one-half of the market (and perhaps only one-third), although the geographic market was not clear. In general, however, in very few cases brought by the Crown did the accused have less than half the market. Moreover, in very, very few cases have the courts applied a quantitative test (as was done in *Quebec Insurance*) in determining if an agreement results in an undue lessening of competition.

Between 1889 and 1990/91 the Crown completed 145 conspiracy and bid-rigging cases in Canada. It obtained a conviction in 95 and a POWC in 19 cases. See Table 6. An analysis of the 31 non-convictions (Figure 2) reveals that they can be grouped into five categories. In ten cases the accused were acquitted because the judge did not find there was an agreement. In 12 cases an agreement was found to exist, but the court (perhaps the court of appeal) concluded that it did not lessen competition unduly. In four cases, the case was decided on other grounds (e.g., on a procedural issue). In two cases, the reason for the discharge at a preliminary hearing could not be determined from the Bureau of Competition Policy's records. Finally, in three cases, the Crown entered a Stay of Proceedings.

Therefore, if we eliminate the last three categories (a total of 10 cases) as they did not address the substantive issues of agreement and unduly, the record indicates that 12 of the 22 "substantive" acquittals were attributable to the qualifying word unduly. These 12 acquittals can be broken down as follows:

- The Trial Court found the agreement lessened competition unduly, but Appeal Court (or SCC) reversed the decision.
    - Aetna Insurance (1977)[69]
- The Trial Court found the agreement was not an undue lessening, and the Appeal Court (or SCC) upheld the decision.
    - Gage (1907)
    - Allied Chemical and Cominco (1976)

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[66] *R. v. Aetna Insurance Co. et al.* (1975) 19 C.C.C. (2d) 449 (Trial); (1975) 22 C.C.C. (2d) 513 (Appeal); (1977) 34 C.C.C. (2d) 157.

[67] *Annual Report of the Director of Investigation and Research, Combines Investigation Act for the year ended March 31, 1985* (Ottawa: Queen's Printer, 1985), p. 17.

[68] *R. v. Electrical Contractors Assoc. of Ontario and Dent* (1960) 127 C.C.C. 273.

[69] The complete citation for each case can be found in Figure 2.

  - Anthes Business Forms (1977)
  - Chatwin Motors (1980)
  - Quebec Insurance Agents (1982)
- The Trial Court (or Preliminary Hearing) found that the agreement was not undue and there was no appeal by the Crown.
  - Beckett (1910)
  - Browning-Ferris (1981)
  - BC Television (1981)
  - Simone Tanner et al. (1982)
  - Metro Toronto Pharmacists (1984)
  - B.C. Fruit Growers (1985)

These data indicate that acquittals due to the agreement not unduly lessening competition are the result of a finding by the trial court (11 of 12 cases) which was upheld upon appeal or was not appealed by the Crown.

An analysis of Figure 2 reveals that 10 of 12 "not undue" acquittals occurred since the mid-1970s. Yet only 58 of the 143 (40.6%) conspiracy cases were completed between 1975/76 and 1988/89. There are several possible explanations for this phenomenon. First, judges have become much more stringent in what they require the Crown to prove in conspiracy cases in terms of the degree of lessening of competition before they will hold it to be undue. Second, the Crown has been taking cases to court where the accused have accounted for a lower share of the market than the "traditional" 75% or more in the cases brought in the 1950s and 1960s when it had a very high conviction rate and only a moderate fraction of guilty pleas (see Table 6). Third, the leading Supreme Court of Canada cases (*Aetna Insurance*[70] in 1977 and *Atlantic Sugar*[71] in 1980) created confusion and uncertainty, e.g., by their discussion of tacit agreements, by allowing the introduction of evidence concerning the benefits said to flow from the agreement, by their use of the "double intent" test, and so on.[72]

It is impossible to know exactly why "unduly" became much more important in explaining acquittals in Canadian conspiracy cases since the mid-1970s. The reasons are beside the point. After a century of living with the illusion that there is any justification for "garden-variety" price-fixing, market-sharing or entry-barring agreements, the time has come to eliminate the word unduly and to make a number of types of common horizontal agreements illegal *per se* by statute.

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70. (1977) 34 C.C.C. (2d) 157.

71. (1980) 54 C.C.C. (2d) 373; 2 S.C.R. 644.

72. See the discussion in Cairns (1981), Dunlop et al. (1987), Engelhart (1981), McFetridge and Wong (1982a) (1982b), Nozick (1985), Reschenthaler and Stanbury (1981a) (1981b), Stanbury, MacCrimmon and Reschenthaler (1984), Stanbury (1985) (1986b).

4.0 "OUT OUT DAMNED SPOT": GETTING RID OF UNDULY

4.1 The Case for a *Per Se* Approach to Bare Cartels

If Canada can ever hope to describe the *Competition Act* as "a comprehensive charter of economic liberty," as the U.S. Supreme Court described the *Sherman Act* in 1958,[73] then the word unduly must be expunged from S.45 (formerly S.32). Certain types of agreements should be made illegal *per se* while all others should be subject to a "rule of reason" test as has been the case since the turn of the century.[74]

The case for a *per se* ban on "garden variety" price-fixing and market-sharing agreements is strong.[75] The toleration of such agreements undermines the most fundamental tenets of a market economy, namely that sellers will act independently in seeking competitive advantage. To fail to condemn as illegal *per se* what one former Director of Investigation and Research acknowledged was "a form of stealing,"[76] is to maintain an indefensible contradiction. In the same vein, in one of the earliest combines cases, the trial judge stated:

> A number of hitherto reputable firms, meeting around a table, and under the pretence of sending in invited tenders, deliberately adopted a method by which, apparently without the slightest compunction, they took from the public, that portion of the public who happened to be interested, money to which they had no possible claim, no more claim than any person has when meeting another in the street he by force robs him of his money. Indeed, I think of the two offences the robbery is the less offensive.[77]

The case for a *per se* approach is that there exist certain restraints of trade that are so clearly anti-competitive in nature, so devoid of any purpose except the stifling of competition that they may conclusively be presumed to be illegal without further inquiry once the Crown has established that such restraint has occurred. Under S.1 of the *Sherman Act* the courts include the following in the *per se* category: horizontal and vertical price fixing, tying arrangements, vertical and horizontal boycotts, horizontal division of markets and reciprocal dealing (Von Kalinowski, 1982, para. 2.02(6)).

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[73] *Northern Pacific Railway v. U.S.* (1956) 356 U.S. 1.

[74] See *U.S. v. Addyston Pipe and Steel Co.* (1897) 175 U.S. 211.

[75] There is some economic analysis which supports the argument that under certain conditions horizontal agreements can be beneficial - see, for example, Telser (1985) and Bittlingmayer (1982) on the "theory of the core"; and Dewey (1979) on the role of agreements in reducing uncertainty. Ross (1991, pp. 9-10) points out that the application of core theory to real antitrust cases is "problematic" for at least three reasons. First, the theory does not tell us what happens when the core is empty (i.e., there is, in the absence of collusion, permanent instability), so we have no idea what the status quo is from which we might apply competition policy. Second, it is not clear that the theory has any empirical content. Third, even if there is a problem it is not clear how competition policy authorities should deal with it - simply allowing them to collude is no solution. As for Dewey's (1979) analysis, De Bow (1988) explains why it is of very limited value for policy purposes.

[76] Statement by Lawson A.W. Hunter, *Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-91*, Issue No. 10, May 20, 1986, p. 7:41.

[77] *R. v. Master Plumbers and Steam Fitters Cooperative Association Limited et al.* (1907) 14 O.L.R. 195 at p. 304.

How can anyone seriously contend that price fixing agreements (whether overt or tacit) are anything other than pernicious in their effect on competition? The U.S. Supreme Court put it very clearly in the *Trenton Potteries* case in 1926:

> The aim and result of every price-fixing agreement if effective, is the elimination of one form of competition. The power to fix prices, whether reasonably exercised or not, involves power to control the market and to fix arbitrary and unreasonable prices.[78]

Note that in the U.S. it is not a defence under S.1 to argue that the price fixing agreement involved a tiny (*de minimis*) amount of interstate commerce.

For price-fixing, market-sharing or entry-barring agreements, the ratio of potential harm to benefit is so overwhelming that it is completely unnecessary to examine them in any detail. As the U.S. Supreme Court put it in 1958,

> There are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use. The principle of per se unreasonableness... avoids the necessity for an incredibly complicated and prolonged investigation into the entire industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable - any inquiry so often wholly fruitless when undertaken.[79]

In the *Socony-Vacuum* case the U.S. Supreme Court emphasized that price-fixing agreements that are illegal *per se* are not only those that fix a uniform and inflexible price. It pointed out that "agreements to raise or lower prices whatever machinery for price-fixing was used" were also condemned. Moreover, "the fact they are fixed at the fair going market price is immaterial."[80] Also condemned are agreements to place a floor under the market, i.e., price stabilization schemes. The Court summarized its position as follows: "Under the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal per se."[81]

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[78] *United States v. Trenton Potteries Co.* (1926) 273 U.S. 392; 47 S.Ct. 377 at p. 379.

[79] *Northern Pacific Railway v. United States* (1958) 356 U.S. 1 (78 S.Ct. 514 at p. 518).

[80] *United States v. Socony-Vacuum Oil Co.* (1940) 60 S.Ct. 811 at p. 843.

Robert Bork and Ward Bowman (1963, p. 138), frequent critics over the years of many aspects of United States antitrust policy, pointed out years ago that "the rule that pricing fixing and similar cartel arrangements are illegal *per se*, that is, incapable of legal justification, must be ranked as one of the greatest accomplishments of antitrust."[82] Moreover, it has been pointed out that

> Even analysts who favour a conservative, or non-interventionist, antitrust policy agree that such a rule is appropriate in economic terms. For example, Posner [1976, p. 39] states that "the elimination of the formal cartel... is an impressive, and remains the major, achievement of American antitrust law." Bork [1978, p. 263] states that "without doubt thousands of cartels have been made less effective and other thousands have never been broached because of the overhanging threat of this rule [the *per se* illegality rule]. Its contributions to consumer welfare over the decades have been enormous" (Dunlop et al., 1987, p. 112).

Dunlop et al. (1987, pp. 110-112) carefully review the case for "bare cartels" and conclude as follows:

> ...bare cartels are unambiguously inefficient - they generate allocative efficiency losses (consumers priced out of the market are forced to allocate their resources elsewhere), and generate no productive efficiency gains over a competitive market structure. Indeed, productive efficiency losses may be entailed if a price-fixing cartel permits the perpetuation of high-cost, inefficient producers who no longer face competitive pressure to reduce their costs or exit from a market.
>
> Thus, most economists favour a *per se* prohibition of price-fixing cartels - effectively the rule adopted by U.S. courts from an early date under the *Sherman Act* (Dunlop et al., 1987, pp. 112).

Price-fixing and market-sharing agreements are arrangements which undermine the competitive market-place. They represent a gross contraction in a free market economy. When competitors are allowed to fix prices in some degree it is an open invitation to impose government regulation to protect the public. Stanbury and Reschenthaler (1981, p. 424) have argued that

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[81] *Ibid.* Note that the U.S. has, in effect, a bifurcated approach to conspiracies in restraint of trade. Certain types of agreements including naked cartels are condemned out of hand - they are illegal *per se*. Other agreements are subject to the "rule of reason" which was first enunciated in *Standard Oil of New Jersey v. U.S.* (1911) 221 U.S. 1, reiterated in *Chicago Board of Trade v. U.S.* (1918) 246 U.S. 231 and repeated more recently in *NCAA v. Board of Regents of University of Oklahoma* (1984) 468 U.S. 85.

[82] More generally, see Bork (1966), (1978).

> agreements on prices and market shares are so intrinsically incompatible with the underlying philosophic foundations of a competitive free enterprise economy as to be categorically unacceptable... They are a form of taxation imposed on buyers... they provide no benefits to society as a whole.

It should be noted that the *Competition Act* already contains two other provisions which are inconsistent with the retention of "unduly" in S.32 (now S.45). First, since 1976 bid-rigging has been illegal *per se* under S.32.2 (now S.47). Second, since 1986 six types of agreements among banks are illegal *per se* under S.33 (now S.49). These include agreements concerning interest rates on deposits or loans, service charges, the amount of kind of loans, and the kinds of services to be provided (Stanbury, 1986).

Professor Michael Trebilcock (1986, p. 3) has described the failure to "render bare cartels (price-fixing or market-division agreements) *per se* illegal" as "an appalling concession to the business community."[83] Exactly. The time has come to remedy the obvious defect in the heart of our competition policy legislation.

The historical record summarized in Figure 2 clearly indicates that the requirement that horizontal agreements lessen competition unduly is not an academic point. It has had a dramatic effect on the ability of the Crown to get the Courts to condemn bare cartels, which as has been noted have no justification in terms of economic efficiency or in terms of equity.

4.2 Previous Efforts to Get Rid of Unduly

1890 to 1900: The history of efforts to eliminate the qualifying word unduly goes back to the year after the original legislation was enacted - and by the man who introduced the private member's bill that became the Act of 1889.[84] In 1890 N. Clarke Wallace introduced Bill No. 77 to delete the words "unduly" and "unreasonably" and to permit employees to combine for the purposes of the *Trade Union Act*. It passed the House but was rejected by the Senate. In 1891, Mr. Wallace tried again but the Bill did not get beyond Second Reading. In 1894 Senator Read introduced a Bill in the Senate to delete the words "unduly" and "unreasonably" from S.520 of the *Criminal Code*. It passed the Senate, but only got as far as First Reading in the House of Commons. The next year, Mr. T. Sproule, a Liberal MP, who had introduced Senator Read's 1894 bill, tried and failed to get the Commons to delete "unduly" in S.520. Sproule repeated his attempt in 1896 and 1898, but failed. In 1899 Mr. Sproule introduced a private member's bill (No. 40) to delete "unduly" and "unreasonably."[85] Bill 40 was passed by both House and Senate as the *Criminal Code Amendment Act, 1899*, 62-63 Victoria, c. 46. However, in 1890, "unduly" and "unreasonably" were restored when the word "unlawfully" was removed.

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[83] The same point is made in Dunlop, McQueen and Trebilcock (1987, p. 289).

[84] This history is taken from Stanbury (1981), Gorecki and Stanbury (1984) and Baggaley (1991).

[85] House of Commons, *Debates*, April 25, 1910, p. 7907.

Economic Council, 1969: The next serious effort to eliminate unduly did not occur until 1969 when the Economic Council (1969, pp. 101-2) recommended that the following practices "be subject to essentially *per se* prohibition under criminal law": collusive arrangements between competitors to fix prices (including bid rigging on tenders); to allocate markets; or to prevent entry of new competitors or the expansion of existing competitors. Unfortunately, the Council muddied the water for reformers by arguing (for poor reasons) that the word "unduly" ought to be retained.

Bill C-256, 1971: The federal government proposed an almost total overhaul of competition legislation in 1971 in the form of a draft bill for comment.[86] Bill C-256 would have made illegal *per se* ten types of horizontal agreements. These included agreements (a) to fix prices; (b) to rig bids; (c) to divide or allocate markets; (d) to lessen or limit the production or supply of a commodity or service; (e) to lessen or limit the quality, grades or kinds of commodity or service; (f) to lessen or limit the facilities for the production, acquisition, supply or distribution of a commodity or service; (g) to lessen or limit the channels or methods of acquisition, supply or distribution of a commodity or service; (h) to prevent or impede entry; (i) to cause any person to abandon or withdraw from any market; and (j) to boycott the supplier or acquirers of a commodity or service.

Several important exceptions from the *per se* ban were provided:[87]

- agreements within the same company or among affiliates
- specialization, export or franchise agreements registered with the Tribunal
- joint ventures which relate to a single project that would be impractical for any of the participants to undertake alone and for which full disclosure was made in advance
- certain agreements for the purpose of promoting efficiency or collaboration on other matters of a non-competitive nature, e.g., product standards, exchange of credit information, R&D, sizes and shapes of containers
- joint purchasing agreements designed to reduce delivery costs
- consumer boycotts (i.e., "designed to remedy particular market situations")
- normal supplier-customer agreements in such matters as defining sales territories, product lines, etc.

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[86] See Canada (1971), Stanbury (1977).

[87] Note that the exemptions did not include farm-in or farm-out and various other arrangements common in the petroleum industry.

- normal covenants associated with the sale of a business or employment contracts.

The Department of Consumer and Corporate Affairs (1971, pp. 76-83) made the following arguments in support of this approach: First, it would bring a higher level of certainty and clarity to this area of the law than presently exists. "The qualifying word 'unduly'... has not been interpreted by the Courts in a way that allows meaningful reference to case law to determine if a proposed action would be considered illegal by the Courts" (p. 80). Second, competition is the most efficient method of allocating resources in a market economy and competition implies that prices and other conditions are fixed by unilateral and independent decisions made in response to market forces. Third, in the Canadian experience, agreements to limit competition have almost universally been harmful to the public interest.

John Howard (1986, p. 2) states that "no provision of that notorious bill [Bill C-256 in 1971] elicited more hostility than Clause 16, the basic conspiracy provision that listed ten *per se* offences which were in essence a catalogue of the kinds of conduct that had led to *per se* liability under the U.S. antitrust laws." In his view, "that hostility was not to the conspiracy provision itself but to the *per se* standard, which precludes any affirmative defence." The intense and concerted opposition of business executives, their lawyers and trade associations forced the government to abandon Bill C-256.[88] Reforms were to be more modest in scope and take the form of amendments to the *Combines Investigation Act*. The Stage I amendments, effective January 1, 1976, which made other changes to the conspiracy provisions, did not touch unduly (see Kaiser, 1979).

Ouellet's 1981 Proposals: In 1981, the Minister of Consumer and Corporate Affairs, Andre Ouellet, proposed to greatly alter the conspiracy provisions in the *Combines Investigation Act*. The provision was to continue to fall under the criminal law as "the evil of conspiracy is self-evident, and there is general agreement that what is needed is a strong criminal provision that will inhibit competitors from getting together to fix prices, allocate markets, retard technological advances, or otherwise harm competition" (Ouellet, 1981, p. 16).

The qualifying word "unduly" was to be eliminated. Agreements to fix prices, allocate market shares, or to restrict a firm from entering or expanding a business were to be made illegal *per se*. In order to eliminate *de minimis* restraints, such agreements had to be shown to "lessen or be likely to lessen competition." Agreements involving other important dimensions of competition (e.g., product introduction, qualities or functions of products or the introduction of technological innovations) were to be deemed to be illegal where the parties to such agreements would jointly account for some given percentage of the relevant market. The exact percentage was left for public debate, but it was generally believed it would be set at 50%.

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[88] But at least one businessman and one well-known lawyer supported the reforms. See Ritchie (1972) and Grover (1972). Generally, see Stanbury (1977).

It was proposed to remove the present exemption under S.32(2) (now S.45(3)) for agreements relating to the exchange of statistics, definition of product standards, packaging and the adoption of the metric system. It was argued by the Minister that "such agreements do not ordinarily lessen competition, in which case they need no protection. Where they [do]... they deserve no protection."

While efforts were made to incorporate these ideas into a bill in 1982, they foundered on the shoals of drafting statutory language that would be broad enough to stop the types of agreements the American courts had long held to be illegal *per se*, but narrow enough not to be open to the criticism that the Crown could attack potentially beneficial agreements or those whose likely adverse effects were *de minimus*.[89]

Bill C-91, 1986: The latest attempt to eliminate unduly from S.32 of the *Combines Investigation Act* (now S.45 of the *Competition Act*) was made by Andre Ouellet (then an opposition Liberal M.P.) during the hearings of the legislative committee on Bill C-91 in 1986. His amendment was defeated by a vote of three to two. The Committee, however, received some questionable advice. For example, L.A.W. Hunter, who had recently resigned as Director of Investigation and Research of the Bureau of Competition Policy, said that conspiracy cases had been lost, not because of unduly, but because of the inability of the Crown to prove agreement. This statement, as shown above, is simply wrong. Hunter said that to his knowledge "no Parliament or legislature has ever enacted a *per se* offence in writing. It has evolved through case-by-case jurisprudence rather than being written down in the statute."[90] This is incorrect too as Sullivan (1977, pp. 165-172) makes clear. The text of S.1 of the *Sherman Act* literally condemns all agreements in restraint of trade. It was the courts that read into the language the idea that only unreasonable restraints were to be condemned, excluding naked price-fixing and market-sharing agreements.[91] Hunter's comment begs the obvious question: is it beyond the wit of Canadian legislators and legal draftsmen to put in writing the rules that have evolved under American case law? More importantly, Hunter did not explain to the Committee that the *per se* bid-rigging provisions introduced in 1976 had worked well: the judges had little trouble with a statutory *per se* approach.[92] Moreover, Hunter did not explain why it was sensible to make several types of agreements among banks[93] illegal *per se* in the same bill that he failed to support a *per se* approach to bare cartels. Nowhere in its hearings did the Committee address this inconsistency.[94]

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[89] The author and Prof. D.L. McQueen participated in the process of turning the Minister's 1981 *Proposals* into a bill. This involved extensive discussions and negotiations with the legislative draftsman appointed by the Department of Justice. Other consultants included T.D. McDonald and Jack Quinlan, both former Directors of Investigation and Research. The effort failed also because the Minister was twice unable to get the permission of Cabinet (in 1982 and 1983) to introduce a bill reportedly because of the opposition of Marc Lalonde. As Minister of Finance following the National Energy Program (introduced in the fall of 1980) debacle, Mr. Lalonde was seeking to improve the Government's relations with the business community. He felt that yet another version of the Stage II amendments (the previous ones were Bills C-42 and C-13 in 1977) would worsen already-strained relations. Mr. Ouellet, therefore, was twice requested to consult more widely on his proposed amendments in order to gain at least some measure of support for new legislation. As a result, the next bill, C-29, was not introduced until 1984 and it did not propose to delete unduly (see Stanbury, 1985).

[90] *Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-91*, Issue No. 8, May 13, 1986, p. 8:6.

Lawson Hunter noted that in the best of all possible worlds he would like a statute making certain agreements illegal *per se*, but it could also result in removing the flexibility that is the "genius of the common law."[95] He suggested that even with well-specified language the courts "have the last word and if you have not convinced them of the importance of what you are trying to do then you do not usually win in the end."[96] This is a potentially serious indictment of the inability of the legislature to implement the policy it sees fit because of the willfulness of judges. It destroys the myth that the legislature makes the laws that embody fundamental policy choices and that the courts merely apply that law to specific cases.

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[91] This was first done in *Addyston Pipe & Steel Co. v. U.S.* (1897), 175 U.S. 211. The classic statement of the "rule of reason" is *Standard Oil Co. v. U.S.* (1911) 211 U.S. 1; *Chicago Board of Trade v. U.S.* (1918) 246 U.S. 231; and *U.S. v. Trenton Potteries* (1926), 273 U.S. 392. Generally, see Sullivan (1977); Areeda and Turner (1978); Areeda (1986); Bork (1966), (1978); Von Kalinowski (1982).

[92] See "First Case Under Combines Law, Bid-Rigging Ban Brings Conviction," *Canadian Competition Policy Record*, Vol. 2(3), September 1981, pp. 34-36. The *Charterways* conviction was upheld in May 1982 (see *Canadian Competition Policy Record*, Vol. 3(2), June 1982, p. 10); "Informality of Bidding Procedure Brings Bid-Rigging Acquittal," *Canadian Competition Policy Record*, Vol. 6(1), March 1985, pp. 25-27; "B.C. Court of Appeal Upholds Acquittal in Bid Rigging Case," *Canadian Competition Policy Record*, Vol. 7(3), September 1986, pp. 9-11.

[93] What became S.33 (now S.49) of the *Competition Act* was essentially copied from S. 309 of the *Bank Act*. It makes six types of agreements among banks illegal *per se*. These include agreements concerning interest rates on deposits or loans, service charges, the amount of kind or loans, and the kinds of services to be provided to a customer. In subsection 33(2) eight exceptions are specified. These include agreements concerning deposits or loans payable outside Canada, underwriting agreements, and those approved by the Minister of Finance "for the purposes of financial policy."

The new S.33 (now S.49) brings agreements among banks under the scrutiny of the Director of Investigation and Research rather than the Inspector General of Banks. Given the small size of the Inspector General's staff, his "closeness" to the banks, and his focus on other regulatory responsibilities, this change should strengthen the application of competition policy to banks. It has yet to be tested, however.

[94] The inconsistency was pointed out in the author's testimony before the Committee. A shorter version can be found in Stanbury (1986b).

[95] See *Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-91*, Issue No. 8, May 13, 1986, p. 8:11.

[96] *Ibid.*, p. 8:11.

Dr. Mel Cappe, ADM Policy Coordination for the Department of Consumer and Corporate Affairs, told the Legislative Committee on Bill C-91 that he agreed in principle that it was desirable to have a *per se* law in respect to certain kinds of agreements. However this change would alter quite substantially the force of the conspiracy law. (That's exactly the point!) He said it would have the effect of catching agreements with a *de minimus* effect. Like Hunter, he noted that Canada would not have the benefit of the decades of jurisprudence that had accumulated in the U.S.[97]

Andre Ouellet argued that the courts in Canada had not lived up to legislators' expectations and that "making it crystal clear that some agreement [sic] among parties is a *per se* offence is not asking the extreme."[98] In his view, with a statute containing a *per se* offence, the courts would not entertain the ridiculous examples (e.g., two kids selling newspapers on opposite sides of the street) given by the opponents of a *per se* approach. In any event, it is possible to draft a *per se* conspiracy provision that exempts agreements that have a *de minimus* or trivial effect on competition without detracting from the essentials of condemning bare cartels.

4.3 Proposed Approach

In reforming the basic conspiracy provisions to eliminate the word unduly Canada has several practical alternatives to consider: Bill C-256 in 1971; Andre Ouellet's *Proposals* of 1981; or simply delete the words "unduly" and "unreasonably" from S.45 (formerly S.32).[99] It is not appropriate in this context to try to offer a complete draft of a new conspiracy section. Rather I set out the central substantive elements that it should contain. First, the law should - along the lines of Bill C-256 in 1971 - contain a list of types of agreements that are illegal *per se*.[100] Second, all other agreements would be illegal only if they had the effect of lessening competition "unduly" or "unreasonably." In the latter case, the courts would be directed to take a "rule of reason" approach. Third, the statute would contain a *de minimus* provision with respect to the list of agreements declared to be illegal *per se*. The test would be whether the likely or actual effect of the agreement on competition would be more than very minor.

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[97] *Minutes of Proceedings... on Bill C-91*, Issue No. 10, May 20, 1986, pp. 10:78-10:79.

[98] *Ibid.*, p. 10:79. Recall that in 1976 Mr. Ouellet resigned following his conviction for contempt of court for his remarks about the trial judge's decision in the *Atlantic Sugar* case (see Stanbury, 1981, p. 11).

[99] This is one of the alternatives proposed by Ross (1991).

[100] Ross (1991, p. 17) points out that "not every agreement to fix prices is called price-fixing" and therefore subject to the *per se* approach. He argues that in the U.S. what types of agreements should be subject to the *per se* approach is "no longer so simple." He cites *NCAA v. Board of Regents of University of Oklahoma* (1984) 468 U.S. 85, *Northwest Wholesale Stationers Inc. v. Pacific Stationery and Printing Co.* (1985) 472 U.S. 284, and Halvorson's (1988) review of decision by the lower courts.

Fourth, the provision would contain a list of exempted agreements somewhat along the lines in Bill C-256, but including many of the routine agreements among firms in the petroleum industry in respect to exploration and development and in the construction industry with respect to limited-duration joint ventures. Fifth, provision would be made for firms to submit to the Competition Tribunal certain types of proposed agreements (e.g., export agreements, joint R & D efforts, specialization agreements). The Tribunal could exempt such agreements if they meet the criteria set out in the legislation. The procedure would be analogous to the present provisions dealing with specialization agreements.[101]

Sixth, the new provisions would make it clear that both overt and tacit agreements are subject to the law. It should be noted that from 1919 to 1960 the *Combines Investigation Act* specifically referred to "any actual or tacit contract, agreement, arrangement, or combination..."[102] This language was retained through amendments in 1923, 1927, 1935 and 1952. The courts - prior to Pigeon, J. in *Atlantic Sugar* - had no difficulty with this language. For example, in *R. v. White* the trial judge stated that an agreement may be either actual or tacit.

> A tacit agreement... is one which a person alleged to have made it may be proved never to have assented to or agreed to it by any word or writing, but which he must be assumed to have assented to by reason of conduct which leads to the reasonable conclusion that he in fact agreed.... his agreement may be taken as a tacit agreement if you can reasonably find from what he does that he must have agreed tacitly to the combination which is alleged.[103]

Yet in *Atlantic Sugar*, Pigeon J. asked, "is a finding of a 'tacit agreement' sufficient for a finding of agreement under a charge of conspiracy" and found he had "great difficulty" in finding that a "'tacit agreement' resulting from the expected adoption of a similar policy by competitors..." amounts to a conspiracy.[104] What Pigeon J., writing for the majority of the Supreme Court of Canada, seems to have said is that a tacit agreement to restrain trade is not the same as an overt agreement to do so. Every time he used the former expression he put the words in quotation marks. This suggests it is not a proper term but a colloquialism or other form of improper or imprecise usage. It should be emphasized that neither Lerner J. in the *Armco* case[105] nor Pennell J. in the *Large Lamps* case[106] had any trouble with the idea that a tacit agreement comes under S.32 of the *Combines Investigation Act*. *Funk and Wagnall's Standard College Dictionary* (p. 1363), for example, defines "tacit" as "existing, inferred, or implied without being directly stated; implied by silence or silent acquiesence." This suggests, per Gertrude Stein, that an agreement is an agreement is an agreement. It may be arrived at overtly or it may be arrived at tacitly, i.e., implied without being directly stated (see Howard and Stanbury, 1990). This needs to be made absolutely clear in the statute.[107]

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[101] See sections 61 and 62 (now 89 and 90) of the *Competition Act* and Stegmann (1979) for a discussion of specialization agreements in general.

[102] More precisely, this language was first used in the *Combines and Fair Prices Act* of 1919 which replaced the *Combines Investigation Act* of 1910 (see Cheffins, 1991). It was declared unconstitutional in 1932 and was replaced by the *Combines Investigation Act* of 1923.

[103] Unreported judgment of the Ontario Supreme Court, April 1, 1932 (excerpts of the judgment obtained from the Bureau of Competition Policy).

[104] (1980) 54 C.C.C. (2d) 273 at p. 381.

Finally, an entirely new civil provision is needed to address the important problem of conscious parallelism that is aided by various "props" or facilitating devices. See the next section.

5.0 CIVIL PROVISION TO DEAL WITH PRACTICES THAT FACILITATE OLIGOPOLISTIC COORDINATION[108]

One of the most common and devilishly difficult problems for public policy is the ability of firms in an oligopoly (the market structure that is ubiquitous in Canada) to coordinate their behaviour to achieve supra-competitive prices, but not form an agreement that could be attacked under S.32 (now S.45) of the *Competition Act*.[109] By definition, oligopolists are interdependent. However, the way that they can relate to each other can range from perpetual warfare to very close coordination resulting in joint monopoly. In other words, prices may hover at or below those that would prevail in a structurally competitive industry or they may be equivalent to those set by a monopolist behind barriers to entry.

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[105] (1974) 21 C.C.C. (2d) 129.

[106] (1976) 34 C.C.C. (2d) 489.

[107] Recall that in Andre Ouellet's 1981 "Proposals," the definition of an illegal agreement or arrangement was to include specifically a tacit agreement "where it can be shown that each of the parties adopts a course of conduct which would significantly lessen competition and intentionally arouse in each of the other parties an expectation that he will continue in that course of conduct if each of them adopts a similar course of conduct" (Ouellet, 1981, p. 17).

[108] Most of this section is taken from Howard and Stanbury (1990). The full argument behind the proposed changes is contained in that paper.

[109] The conscious parallelism cases in Canada are discussed in Webber (1982), Stanbury and Reschenthaler (1977) and Nozick (1985).

Because it is all but impossible for oligopolists to coordinate their behaviour so as to achieve persistent supra-competitive prices without relying on one [or more] "facilitating devices" or "plus factors," the proposed approach is to create a new civil reviewable matter that focuses on these devices. In the same vein, Christopher Green states that his analysis of the combines reports and cases suggests that "oligopolistic coordination is difficult and usually requires some form of arrangement plus a method(s) of propping up that arrangement when inevitably economic shocks, including simply the forces of demand and supply, tend to undermine the arrangement."[110] Therefore, he proposed that the "conscious parallelism plus"[111] approach should be adopted where the focus is "on the efforts of oligopolists to prop up joint behaviour."[112]

The proposed approach to facilitating practices falls within what is called the valid business rationale in current antitrust jurisprudence developing in the U.S.[113] Bock (1988, p. 109) puts it this way: the appropriate test is "whether [an alleged facilitating] practice is reasonable under the competitive circumstances, because if it is, it is likely to increase competitive rivalry, lead to additional output, intensify innovation, and in the end result in lower prices and/or more effective products or services for customers." In analyzing the facts of each case "the major question is not whether a particular practice is common to a group of sellers but whether it is primarily designed to increase economic efficiency and make markets more rather than less competitive" (Bock, 1988, p. 11).

In the same vein, Vaska (1985, p. 53) proposes that a two-pronged inquiry be used in cases of conscious parallelism with facilitating practices. The first prong would involve a "business-justification" test under which the Attorney General or the private plaintiff "must establish a prima facie case by proving conscious parallelism and suggesting a motive for the defendants to collude." Then the defendants assume the burden of "proving that the conduct would have been in the self-interest of each firm acting independently." The plaintiff, however, would have the "ultimate burden of showing that no defendant would have engaged in the parallel conduct unless all did" (Vaska, 1985, p. 531).

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[110] Personal communication, June 1981.

[111] See Stanbury and Reschenthaler (1977) and Royal Commission on Corporate Concentration (1978, pp. 85-88; 96-98).

[112] Green acknowledges that there are problems in making "conscious parallelism plus" part of the criminal law of conspiracy. First, it would be a criminal offence with a higher standards of proof than would be required if the provision was in civil law. Second, the judge would have to find there was an agreement among the firms to adopt the "plus factors" used to facilitate parallel behaviour. While the existence of such an agreement may be inferred by the judge or found to be a tacit agreement, this puts us squarely within the law on conspiracy (Personal communication, June 1981).

[113] See, for example, *Broadcast Music, Inc. v. CBS Inc.* 441 U.S. 1 (1979); *Matsushita Electric Industrial Co. v. Zenith Radio Corp.* 106 U.S. 474 (1986); and *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.* 472 U.S. 485 (1985). These and other relevant cases are discussed in Bock (1988).

The second prong of the test consists of a rule-of-reason inquiry which would focus on finding adverse market effects rather than on evidence of collusion. "For example, if the defendants collectively do not have market power, even a formal agreement would be unsuccessful in affecting the market price" (Vaska, 1985, p. 531). Vaska (1985, pp. 531-534) suggests that in the *Boise Cascade Corp. v. FTC*[114] and *Ethyl Corp./Dupont*[115] cases some U.S. courts have been adopting his suggested approach.[116]

It is proposed that the federal government enact a new administrative reviewable matter in the *Competition Act* to enjoin facilitating practices where the Director of Investigation and Research is able to establish[117] the following:

(i) the practices are avoidable, i.e., they are not necessary for the market to operate efficiently,

(ii) there is substantial evidence of non-competitive performance over a period of time (the focus should be on supra-competitive prices),

(iii) the social costs of the practices outweigh their benefits to society (not the firms), and

(iv) the non-competitive performance is reasonably attributable to or made worse by the use of the facilitating practices.

This approach is similar to that proposed by Areeda (1986). In cases involving oligopoly with facilitating practices, the Director would have three evidentiary tasks: "to show (1) that price competition was substantially attenuated; (2) that the result could be traced in some significant degree to the challenged practices; and (3) that any competitive benefits of the practices were less than the competitive harm" (Hay, 1982, p. 477).

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[114] 637 F. 2d 573 (9th Cir, 1980).

[115] 101 F.T.C. 425 (1983) reversed in 729 F. 2d 128 (2nd Cir, 1984).

[116] Vaska (1985, pp. 528-530) argues that his approach is superior to the *Venzie* test more commonly applied by the U.S. courts, in part because a tacit agreement inferred from parallel behaviour under the business-justification test should not be considered illegal. Why? First, because "economic theory suggests that informal agreement cannot be successful except in the context of oligopoly." Second, the *Venzie* test can lead to an inference that the defendants have agreed to parallel conduct that may affect price and this need not be the case. Third, the market consequences of many parallel business practices are ambiguous, e.g., delivered pricing may be pro- or anti-competitive (Vaska, 1985, p. 530). In *Venzie Corp. v. United States Mineral Products Co.* [521 F. 2d 1309 (3rd Cir., 1975)] the court applied a two-part test synthesized from previous decisions. For an agreement to be inferred from evidence of conscious parallelism "there must be (1) a showing of acts by defendants in contradiction of their own economic interests, and (2) a satisfactory demonstration of motivation to enter an agreement" (Vaska, 1985, p. 523).

[117] Such cases would be adjudicated by the Competition Tribunal.

The statute should not require that the practices be adopted as a result of an agreement or that the respondents had formed an agreement with respect to prices, output, market shares, etc. Our objective is to strike at practices or mechanisms that reduce uncertainty and help to overcome the natural centrifugal (pro-competitive) forces in oligopolies. By taking away oligopolists' props uncertainty should be increased and so should the likelihood that the performance of oligopolies will more closely approximate that of a structurally competitive industry. It must be remembered that the performance characteristics of an oligopoly may range from that of a perfectly competitive industry to that of a monopoly. In Canada in particular, structural remedies are ruled out in most cases on efficiency grounds and in many cases on political grounds. However, it is both practical[118] and politically acceptable to make close coordination among oligopolists more difficult by eliminating the use of facilitating mechanisms.

Obviously cases of oligopoly with facilitating practices will require an extensive analysis before the Competition Tribunal. Moreover, the Tribunal will have to carefully weigh the benefits and costs of such facilitating practices because, *a priori*, the effects of most facilitating practices are usually ambiguous. Therefore, the Tribunal will have to focus on the effects of the practices as they operate in the context of the structure and conduct of specific markets, not in the abstract.

6.0 OTHER REFORM PROPOSALS

6.1 Penalties and Remedies

Larger Fines: While the data in Table 7 indicate that the average fine per firm and per case in conspiracy cases has increased in real terms since the turn of the century, they do not seem to belie the idea that price fixing is a crime that pays. Logically, fines have to be large enough, in the words of one judge, "to assure that there is no profit in the criminal conduct in question." He went on to say, "The Court must do its best to see to it that the fine is of sufficient quantum to take away any profit earned by reason of the criminal marketing scheme [this was a resale price maintenance case] and, in addition, and of importance, to be a strong deterrent."[119] A U.S. presidential task force put it this way, "The fines must be increased to a point where they will give even the large corporation considerable pause before participating in (or condoning its officers' individual participation) an illegal conspiracy."[120]

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[118] This approach assumes it is feasible and effective to ban or dismember the facilitating device/practice. For example, in the consent order regarding turbine generators, General Electric and Westinghouse are prohibited from "using public announcements of pricing policy, from publishing price quotations or catalogs by which prices can be estimated and from the use of any pricing policy similar to a most-favored-nation [customer] clause..." (Elzinga, 1984, p. 12).

[119] Brooke, J. in *R. v. Browning Arms Co. of Canada Ltd.* (1974) 18 C.C.C. (2d) 298 at pp. 300-01.

The result is that the largest fine prior to December 1990 levied on a corporation in a conspiracy or bid-rigging case was $400,000.[121] These fines can be placed in perspective by noting that in the famous *Dredging* case, which involved bid-rigging and fraud under the *Criminal Code*, the fines imposed on eight corporations ranged between $450,000 and $2 million. Two corporations were fined $1 million, one, with its subsidiary, was fined $1.5 million, and one was fined $2 million.[122] The fines totalled almost $7 million in a case in which the Crown alleged the accused defrauded the public sector of about $4.2 million. In addition to the high fines, five executives were sentenced from two to five years imprisonment.

The Ontario Court of Appeal described the collusive bidding practices in the dredging industry as a "shocking state of affairs" which defrauded the government of millions of dollars. They held that general deterrence is the paramount factor in imposing sentence. They agreed with the trial judge that "the benefits contemplated or actually received were factors relevant to the imposition of a monetary penalty."[123] The Court of Appeal emphasized that it was of little importance for the purpose of sentencing that contemplated profits from the conspiracy were not realized.[124]

The Court of Appeal also held that "we cannot assume that the civil actions commenced will result in any recovery and in any event, even if successful, they are not, in our opinion, a substitute for the deterrence of a penal sanction."[125] Further, the Court stated that "the rationale for the imposition of fines against corporations is that fines are virtually the only penal sanction which may be imposed."[126] One of the purposes of such fines, they said, is not to punish innocent shareholders, but "to prevent the corporation from retaining illegally acquired profits." In the case at hand, "the potential economic benefits were very high in comparison to the risks" and the prosecution depended on the co-operation of some of the participants.[127]

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[120] *Report of the Task Force on Productivity and Competition* as reprinted in *Antitrust Law and Economics Review*, Vol. 2, No. 3, Spring, 1969 at p. 33.

[121] In the flour milling case seven firms pleaded guilty to bid-rigging in December 1990, January 1991 and April 1991. Three were fined $1 million each. The lowest fine was $30,000. In June 1991 the eighth firm agreened to Prohibition Order without conviction. Therefore, the average fine for all eight defendants was $425,625.

[122] *R. v. McNamara et al.* (Supreme Court of Ontario, Toronto, June 11, 1979, Parker, C.J.). The sentences were varied only in a minor way. See *R. v. McNamara et al.* (No. 2) (1981) 56 C.C.C. (2d) 516 (Ont. C.A.).

[123] *R. v. McNamara et al.* (No. 2) (1981) 56 C.C.C. (2d) 516 at p. 523.

[124] *Ibid.*, at p. 523.

[125] *Ibid.*, at p. 524.

[126] *Ibid.*, at p. 526.

Crime certainly appears to pay when it comes to conspiracy cases in Canada. Consider the *Large Lamps* case. Although the Crown requested that the three firms involved by fined $400,000, $600,000 and $1,000,000 respectively, the court imposed fines of $100,000, $150,000 and $300,000 respectively.[128] It did so almost ten years after the end of the period of indictment (1959-1967), yet no prejudgment interest was applied. During the period 1959-1965 the judge stated the three firms' sales of large lamps totalled $238.5 million. Gorecki (1981, p. 199) puts the total for the entire period of the indictment at $295 million. In passing sentence Pennell J. stated that "the evidence leaves no room for doubt that all three defendants realized increased profits as a result of the conspiracy [but] it [was] not a case where the public has been held to ransom by the charging of exorbitant prices."[129] The Restrictive Trade Practices Commission (1971, Appendix C) report indicated that between 1959 and 1967 the price of the 25 and 40 watt household lamps went up 33.3% in Canada but declined by 3% in the U.S. In the case of 40 watt four-foot fluorescent tubes, Canadian prices rose 5.4% while those in the U.S. fell by 18.2%. Therefore, while no specific evidence of the profitability of the arrangement is available, so long as the accused were able, as a result of the conspiracy, to raise their prices by 0.19% they benefitted by the offence.

This result might be compared to the penalties in a 1982 tax evasion case. A B.C. man was sentenced to a year in jail and was fined $100,000 for evading about $270,000 in federal and provincial income taxes. In addition to paying the taxes and the criminal fine, he paid $121,000 in interest and penalties.[130] One might also consider the sentences meted out in the U.S. recently in respect to securities violations, including insider trading. In 1986, Ivan Boesky, the famous arbitrageur, paid fines and penalties of (U.S.) $100 million and was sentenced to three years in jail.[131] In September 1989, Drexel Burnham Lambert Inc. pleaded guilty to six counts of securities law violations and paid (U.S.) $673 million in fines and penalties.[132] In April 1990, Michael Milken

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[127] *Ibid.*, at pp. 526-527.

[128] *R. v. Canadian General Electric et al.* (1977) 35 C.P.R. (2d) 210.

[129] *ibid.*, at pp. 213-214.

[130] Vancouver *Sun*, June 26, 1982, p. A3. Under the *Income Tax Act* a person convicted of evasion must pay restitution (i.e., the amount of taxes evaded), interest on the taxes, a penalty of up to 50% of the tax evaded plus a criminal fine of between 25% and 200% of the amount of tax evaded. Individuals may also be imprisoned for up to two years. See *Income Tax Act* Chap. 63, S.C. 1970-71-72 as amended, section 239.

[131] *Maclean's*, December 3, 1990, p. 44.

[132] *Globe and Mail*, September 12, 1989, p. B1.

(who earned $550 million in 1987 at Drexel) pleaded guilty to six felony counts related to fraudulent activity in trading securities and paid (U.S.) $200 million in fines plus $400 million in restitution.[133] A few months later, Milken was also sentenced to 10 years in jail,[134] plus 1800 hours of community service during each of three years probation.[135] In each case, it seems clear that the U.S. federal government has sought fines or economic penalties that offset the economic gains from illegal behaviour - and to obtain deterrence by imprisoning high profile defendants.

The key issue with respect to penalties in conspiracy cases is not the size of the maximum fine specified in the statute,[136] but the need to convince judges to take an "economic approach" in determining the amount of the fine.[137] Under such an approach the Crown would argue that price-fixing or market-sharing agreements are not the result of moral lapses, but rather stem from a weighing of the potential economic costs and benefits of engaging in cartelization. Where the accused have taken an economic approach they take into account such variables as the probability of being caught, convicted and penalized; the likely increase in profits attributable to an agreement with competitors; and the likely lag between the time the benefits are received and the costs are incurred. This approach would require expert testimony by accountants and economists as to the benefits accruing to the conspirators, and the average probability of being convicted (obviously not all price fixers get caught and convicted). Moreover, the time value of money must be incorporated into the analysis or the accused could obtain the benefit of an interest-free loan even if the fine extracted all the gains from the agreement. In addition, the fine should take into account the fact that most executives are risk averse. Therefore, the fine need not be equal to the present value of the expected increase in net profits attributable to the conspiracy. While it will often be the case that the Crown will not be able to provide the judges with accurate estimates of the various numbers that are involved in a strictly economic approach to fines in conspiracy cases, its value lies in the process of thinking along these lines. Even rough estimates of some of the parameters are more likely to produce the approximately correct penalty than the present approach.[138]

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[133] *Newsweek*, May 7, 1990, p. 48. He was left with an estimated net worth of up to $1 billion.

[134] *Newsweek*, December 3, 1990, p. 42. For a critique, see Paul Craig Roberts, *Business Week*, December 17,1990, p. 18.

[135] *Financial Post*, November 22, 1990, p. 12.

[136] During the debate on Bill C-91 which became the *Competition Act* of 1986, the former Liberal Minister of Consumer and Corporate Affairs, Andre Ouellet, argued that an unlimited fine "might not be a signal to the courts, whereas, if we raise the amount currently under the act by ten times, surely they will see the signal." (See *Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-91*, Issue No. 10, May 20, 1986, p. 10:82. Mr. David Orlikow's (NDP-Winnipeg North-Centre) amendment to make the maximum fine unlimited was rejected. See *Minutes*, pp. 10:80-10:82 at p. 10:82.) In Bill C-29 introduced in April 1984 (described and discussed in Stanbury, 1985), but not enacted, the Liberal Government argued that by doubling the maximum fine to $2 million "Parliament will be clearly indicating the seriousness with which it views conspiracies in restraint of trade." Also it would be "potentially increasing the deterrent effects of such a penalty" (Dept. of Consumer and Corporate Affairs, 1984, p. 12).

[137] See, for example, Becker (1968); Baker (1981); Beckenstein et al. (1981); Elzinga and Breit (1976); Breit and Elzinga (1986); Landes (1983); Polinsky and Shavell (1979); Stanbury (1976); Werden and Simon (1987); U.S. Sentencing Commission (1987); Dau-Schmidt (1983); Schwartz (1980).

The Commission (1987, p. 152) clearly takes an economic approach to sentencing in cases involving price-fixing, noting that "it is estimated that the average additional profit attributable to price fixing is 10 percent of the selling price." The U.S. Sentencing Commission (1987, p. 153) argues that "substantial fines are an essential part of the sanction" in conspiracy cases. It notes, however, that the average fine per corporation in such cases in the U.S. is "approximately $160,000" (versus $27,000 for individuals).[139] (This is over two times the average fine per firm in Canada in the 1980s - see Table 7.) The Commission recommends "a fine of two to five times that amount [i.e., 20% to 50% of sales] be imposed on organizational defendants as a deterrent because of the difficulty in identifying violators." In any event, the U.S. Sentencing Commission (1987, p. 151) recommends that firms be fined not less than $100,000.[140]

It is possible to rely too heavily on very large fines relative to enforcement efforts to deter price fixing,[141] but Canada is very far from that situation. The case for the Crown to argue for an economic approach to determining the appropriate fine in conspiracy cases is overwhelming.

The Director acknowledges that the present level of fines "has not even begun to achieve... deterrence" in conspiracy cases; "the fines have functioned as little more than a licence fee" (Wetston, 1990, p. 9). It appears that he supports the approach proposed here. He has argued that conspiracies can be deterred only if the penalties are greater than the expected profits from successful collusion (Wetston, 1990, p. 9).

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138. For a discussion of the criteria judges have used in Canadian combines cases, see Stanbury (1976) and Brockman (1984).

139. The Commission (1987, p. 153) states that "currently approximately 39 percent of all individuals convicted of antitrust violations are imprisoned." However, the average time served recently was only 45 days.

140. The U.S. General Accounting Office (1990, p. 13) states that for criminal violations of antitrust laws "individuals and corporations may be fined twice the gross pecuniary gain the defendant derived from the crime, or twice the pecuniary loss imposed in another by the crime." This is over and above the maximum fines of $250,000 for individuals and $1 million for corporations.

141. See Block and Sidak (1980) whose analysis is discussed below.

Removing the Inconsistency in Maximum Fines: A review of various criminal offences in the *Competition Act* reveals great inconsistencies in the maximum fine or period of imprisonment:

Section	Max. Fine	Max. Imprisonment
• S.32 (45), conspiracy	$10 million	5 years
• S.32.2 (47), bid-rigging	no limit[142]	5 years
• S.32.1 (36), foreign directives	no limit	not applicable
• S.32.3 (48), professional sports	no limit	5 years
• S.33 (49), agreements among banks	$5 million	5 years
• S.34 (50), price discrim.; predatory pricing	no reference to a fine	2 years
• S.36 (52), misleading advertising (by indictment)	no limit	5 years

Why, for example, is the maximum fine for an agreement among banks to fix the interest rate on loans, which is a *per se* offence, set at $5 million, while that for bid-rigging, another *per se* offence, set at the discretion of the court? It my be due to the fact that the latter provision was enacted in 1975 while the former was enacted in 1986.

Note also that the limit for a nation-wide price fixing agreement that lessens competition unduly is $10 million ($1 million from 1976 to 1986), while a court may impose a potentially unlimited fine in a misleading advertising case (albeit one by indictment rather than summary conviction), or a price discrimination case. On the other hand, individuals convicted of predatory pricing or price discrimination face a maximum of two years imprisonment while price fixers, bid-riggers or those whose advertising is misleading may be sent to jail for up to five years.

Logic is on the side of making the maximum fine consistent across offences likely to cause comparable amounts of harm. There is a danger, however, that too much emphasis will be placed on the political symbolism of a large maximum fine graven in stone in the statute. For example, it appears that raising the maximum fine for S. 45 (previously S. 32) to $10 million was an essentially symbolic gesture designed to offer reassurance to the average voter without inconveniencing the corporations subject to the conspiracy provisions. It would be much more useful, in the name of enforcement, to eliminate unduly and/or persuade the Crown to advance an economic approach in speaking to sentences in conspiracy cases.

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[142] The size of the fine is at the discretion of the court.

Imprisonment for Price Fixers: The case for sending businessmen (and women) to jail for price fixing (or other *per se* offences) is compelling.[143] This approach would supplement the economic approach which would rely solely on large fines or private suits for multiple damages. Werden and Simon (1987, pp. 923-937) explain why a purely economic approach to fines in antitrust cases is not quite the perfect solution it is cracked up to be: First, the optimal fine could easily be beyond the ability of individual or corporate defendants to pay, i.e., it could exceed their net worth. Second, the justice system would have to expend considerable resources in determining the ability of defendants to pay the large fines implied by the economic approach. Third, there is no principled way to determine the appropriate trade-off between fines and imprisonment for those defendants unable to pay.

Block and Sidak (1980, pp. 1132) point out that on efficiency grounds (low enforcement costs), it would make sense to "hang a price fixer now and then."[144] Moreover, the deterrence effect should be very high. Block and Sidak (1980, pp. 1133-1138) explain that there are four economic arguments against an enforcement strategy that combines a low level of enforcement and detection with fines or damages of extremely large size as usually advocated on the grounds of efficiency: overinvestment in private enforcement, marginal deterrence, risk-bearing and the possibility of error. For these reasons a purely economic approach to antitrust enforcement is unlikely to be efficient in practice.

There are other arguments for imprisoning price fixers. Jail carries with it a high level of stigma for white collar defendants, far more than for blue collar criminals (see Braithwaite, 1985). That is precisely why even a short prison sentence is likely to have a strong deterrent effect among potential price fixers who are business executives.[145] As important is the idea that the punishment should fit the crime. Theft usually results in imprisonment. Price-fixing is a form of white collar theft.[146] Therefore, price-fixing should be punished by imprisonment in addition to fines that remove the economic benefits of fixing prices.

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[143] But Gary Becker (*Business Week*, March 13, 1989, p. 22) argues that "if there are appropriate fines, there is no reason to jail officials of corporations that commit security fraud, antitrust violations, tax evasions and similar crimes. Directors of companies that pay large fines for crimes committed by their officials have an incentive to fire them or force them to clean up their act. Imprisonment is inferior because prisons are costly to maintain."

[144] However, Snyder (1990) suggests that tougher penalties in the form of imprisonment of executives will result in fewer guilty pleas and more extensive efforts to defend. Also the courts might be reluctant to convict in the face of what they perceive to be very strong penalties.

[145] See "White Collar Shame," *Newsweek*, November 28, 1988, pp. 58-59.

[146] "Hard-core price fixes are intentional conspiracies to steal from consumers, and the negligible probability that the outcome is efficient can be safely ignored" (Werden and Simon, 1987, p. 932).

It is essential that bare cartels should be eliminated, not merely taxed "like overtime parking" (Werden and Simon, 1987, p. 933). Deterrence can be increased by having the judicial system (as well as the legislature) recognize that price fixing is a serious act. We don't just fine cocaine dealers - we imprison them and try to recover their ill-gotten gains. Recently the Chairman and CEO of Noranda Forest Inc. has said that "it's reasonable that there be jail sentences for overt acts of either mishandling or attempting to get around [environmental pollution] regulations."[147]

While the sentence need not be long - say six months - as there are diminishing marginal returns to imprisonment, it should be served in regular jails, not special "country club" facilities for white collar felons.

Posner (1970, p. 389) notes that

> The first prison sentence for 'pure' price fixing in the U.S. was imposed in the 1955-59 period. The next such was in the electrical-equipment case of 1960, when seven company officials were given 30-day terms. Prison sentences have been imposed in two cases [up to 1969].

Between 1963 and 1973 some 4.8% of conspiracy convictions in the U.S. resulted in jail terms. Then from 1974 to 1984 the ratio increased to 20% following passage of the *Antitrust Procedures and Penalties Act* of 1974 (Gallo et al., 1985). In fiscal 1984 and 1985 some 126 individuals were sentenced in criminal price-fixing cases in the U.S.. The government recommended jail terms for 107 and 40 were imprisoned (Werden and Simon, 1987, p. 918).

In Canada, no business executive has been imprisoned for violating the *Competition Act* or its predecessors over the past century.[148] Indeed, it was less common in the 1970s and 1980s to even charge a business executive with a violation of S.32 (now S.45).[149] In earlier times, the Crown sometimes charged the individual believed to be responsible for organizing the conspiracy. For example, in 1905 the president of the Ontario Coal Association was convicted of organizing an extensive price-fixing conspiracy. He was fined the maximum amount at the time: $4000.[150] (This is equivalent to about $70,000 in 1989 dollars.) In 1908 the president of the Alberta Retail Lumber Dealers Association was convicted of conspiracy, but he was fined only $500.[151] In one of the plumbing conspiracy cases in the 1930s, the Crown charged only executives even when there were corporate entities that could have been charged.[152]

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[147] Interview with Adam Zimmerman, *Financial Times*, May 15, 1989, p. 53. Recent amendments to British Columbia's environmental protection legislation provide for imprisonment for up to three years.

[148] In *R. v. Simington* (1926) 45 C.C.C. 249, which began as a combines case, but charges were dropped in favour of prosecution for fraud under the *Criminal Code* and the *Secret Commissions Act*, the four executives were fined $25,000 and sentenced to one day imprisonment. In December 1974 an individual was imprisoned for two years with respect to a charge of misleading advertising (then S. 37). The accused had a criminal record. The sentence was later reduced to one year. See *Annual Report of the Director of Investigation and Research* for the year ended March 31, 1975 (Ottawa: Information Canada, 1975), pp. 40-41; and the 1975/76 *Annual Report*, p. 67. In two other misleading advertising cases prison sentences of only one day were imposed. During 1989/90 an individual was sentenced to six months in prison for failing to pay a $30,000 fine in a misleading advertising case - see Addy in Part 6 of this volume.

[149] The Director points out that "although about forty individuals have been convicted of 'combines' offences since 1940, individual fines have not exceeded $7500 to date" (Wetston, 1990, p. 9).

In *R. v. White* in 1932 11 plumbing contractors were convicted as individuals, fined $100 each and given a one year's suspended sentence. In 1942, H.J. Badden was convicted in *R. v. Bathurst Power and Paper et al.* but only fined. Nine individuals were charged in *Imperial Tobacco*, and not because they were owners of unincorporated businesses. In the Winnipeg coal case in 1957 eleven individuals were charged, but all were small coal dealers. In 1961 C.W. Dent, head of the Electrical Contractors Association of Ontario, was charged separately from the Association, convicted and fined $7500 (see Tables 4 and 5).

In the *Mandarin Orange* case in 1967 the executive who was charged, but the Crown entered a *nolle prosequi*. The same thing occurred in the *Alberta Plumbing Supplies* case with respect to six executives in 1968 and to one individual in the *Montreal Plumbing Supplies* case in 1968.[153] It is not clear why this was done, but in every case the Crown obtained a conviction against the companies involved.

Beginning in the 1950s and through 1980s it was apparently the practice of the Crown to charge individuals only if they were the owners of unincorporated enterprises.[154] Individuals were frequently named as unindicted co-conspirators and used by the Crown to provide evidence to convict corporations. The logic of convicting a number of corporations of conspiracy while failing to charge the individuals who are the directing minds of these legal, but inanimate entities is hard to fathom.

It appears that the current Director of Investigation and Research appreciates that deterrence will require that "severe penalties" be borne by

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[150] *R. v. Elliott* (1905) 9 O.L.R. 648 (Trial); 9 O.L.R. 656 (Appeal).

[151] *R. v. Clarke* (1907) A.L.R. 358 (Trial); (1907) A.L.R. 368 (Appeal).

[152] *R. v. Singer et al.* (1931) O.R. 202 (Trial); (1931) O.R. 699 (Appeal); (1932) 2 D.L.R. 866.

[153] Information obtained from the Bureau of Competition Policy.

[154] An obvious exception occurred in the *Barton Tubes* case. The executive who was charged was discharged at the preliminary hearing. See *Annual Report of the Director of Investigation and Research* for the year ended March 31, 1979 (Ottawa: Minister of Supply and Services, 1979), p. 98.

"the executives responsible for the decision to break the law" (Wetston, 1990, p. 10). The Director has indicated that in conspiracy and bid-rigging cases he is very likely to recommend to the Attorney General that individuals be charged. The criteria for doing so include "the position of the individuals in the organization, his or her role initiating, implementing or enforcing the agreement and the degree of knowledge of illegality, or moral turpitude of the particular party" (Wetston, 1990, p. 10). In the Quebec pharmacists case, charges were laid against seven corporate officers (Wetston, 1990, p. 10).

In summary, the Crown should adopt a policy of charging individuals who are party to agreements to fix prices, divide up markets, etc. Then, if they are convicted, the Crown should routinely seek short jail terms for the offenders. The United States Sentencing Commission (1987, pp. 152-153) guidelines require at least four months imprisonment. The Commission noted that about 39% of individuals convicted of antitrust violations were imprisoned and that the average time served was 115 days (45 days considering all defendants sentenced).[155]

6.2 Reinforcing Public Prosecutions

As noted above, the enforcement of S.1 of the *Sherman Act* in the U.S. has been very strongly reinforced by private actions, including class actions and *parens patriae* actions by state attorneys-general. Indeed, there are 10 times the number of private treble damage actions than public antitrust prosecutions in the U.S.[156] The present provisions for civil actions in the *Competition Act*, together with the general rules of court with respect to the awarding of costs provide insufficient incentive for private plaintiffs to enforce competition policy legislation in Canada.

Private Civil Actions: The role of private civil actions in competition policy cases is to try to extract from the convicted price fixers their "ill-gotten gains" and to deter other potential price fixers by increasing the cost of doing so and getting caught. An action for double damages should both make the game worth the candle and act as a deterrent to other firms inclined to form agreements in restraint of trade. Note that Bill C-256 in 1971 provided for the courts to award damages up to double the loss or damage suffered as a result of a horizontal agreement. Moreover, it provided that a plaintiff could proceed whether or not a conviction had been obtained, but subject of course to proof of the offence (see Stanbury, 1977, p. 91).

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[155] The U.S. General Accounting Office (1990, p. 13) states that Sentencing Commission guidelines require (absent mitigating factors) a minimum four-month sentence for individuals where their company had sales of $1 million to $4 million.

[156] Salop and White (1988, p. 4) indicate there were 2789 antitrust cases initiated by the federal government between 1941 and 1984 and 28,509 private actions during the same period. Three-quarters of the private cases involve an alleged violation of S.1 of the *Sherman Act* (p. 38): 21.3% allege horizontal price fixing; 10.3% allege vertical price fixing (pp. 38-39). More recent data can be found in Latimer's paper in Part 2 of this volume.

In Canada, there was no provision for private actions prior to 1976, and then successful plaintiffs can recover only single damages and "costs" which rarely cover one-half the outlays on the case. Moreover, it has taken 13 years to resolve the ambiguity of the provision's constitutionality. Not surprisingly, very few cases have been launched even though the Crown has won 41 convictions or POWCs in conspiracy and bid-rigging cases between 1975/76 and 1990/91 (Table 6).

The constitutionality of S.31.1 (now S.36) has been in doubt from the time the provision came into effect in 1976 until the Supreme Court of Canada's decision in the *General Motors* case in April 1989.[157] Two of the earliest trial decisions reported in 1979 and 1980 held that S.31.1 was unconstitutional.[158] Another upheld it.[159] MacCrimmon (1983, p. 575) states there were five actions under S.31.1 by 1982 in three of which the constitutionality was challenged. Because of the difficulties in bringing a class action and the limitation to single damages, MacCrimmon (1983, p. 576) argues that "the injured are more likely to rely on a tort action for damages for conspiracy." There have been a few of these actions.[160]

It may well be that the initial decision holding that S.31.1 (now S.36) was unconstitutional in 1979, together with the protracted nature of the *Rocois* case, effectively deterred other private actions under competition legislation. The *Rocois* and *General Motors* decisions may "open the floodgates" to private antitrust actions in Canada - but that seems unlikely given the modest economic incentives involved for such actions.

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[157] *General Motors of Canada Limited v. City National Leasing* (Decision of Supreme Court of Canada, April 20, 1989; (1989) 24 C.P.R. (3d) 417. The earlier decisions in this case are (1984) 12 D.L.R. (4th) 273 (Trial); (1986) 28 D.L.R. (4th) 158 (Appeal). The *General Motors* case involved allegations that the price discrimination (S. 34(1)(a)) had been violated. On the same day, the Supreme Court of Canada upheld (6:0) the constitutionality of S. 31.1 of the *Combines Investigation Act* (now the same provision in the *Competition Act*) in the *Rocois* case for the same reasons as it adopted in the *General Motors* case which was heard at the same time. See *Quebec Ready Mix Inc. et al. v. Rocois Construction Inc.* (1980) 1 F.C. 184 (Trial); (1985) 2 F.C. 40 (Appeal); Unreported judgment of the Supreme Court of Canada, April 20, 1989; Bureau of Competition Policy mimeo 318-3. In summary, the Supreme Court of Canada (6:0) held that the *Combines Investigation Act* contains a regulatory scheme valid under S.91(2) of the *Constitution Act, 1867*, the trade and commerce power.

[158] *Seiko Time Canada v. Consumers Distribution Co.* (1980) 29 O.R. (2d) 221 (Ont. H.C.), affirmed by (1981) 34 O.R. (2d) 481 (OCA); *Rocois Construction Inc. v. Quebec Ready Mix Inc.* (1979) 51 C.C.C. (2d) 516.

[159] *Henuset Bros. Ltd. v. Syncrude Canada Ltd.* (1980) 52 C.P.R. (2d) 173 (Alta. Q.B.).

[160] See, for example, *Alberta Pork Producers Marketing Board v. Swift Canadian Co.* (1981) 16 Alta. L.R. (2d) 313; 129 D.L.R. (3d) 411; *B.C. Lightweight Aggregate v. Canada Cement LaFarge Ltd.* (1981) 4 W.W.R. 385 (BCCA); (1983) 145 D.L.R. (3d) 385 (SCC). See also *Valley Salvage* case.

The number of private actions is not helped by the fact that in some provinces, notably Ontario, contingency fee arrangements are banned.[161] According to a Toronto lawyer, Ontario is the only jurisdiction in North America that doesn't have contingency fees.[162] The Attorney General of Ontario, however, has a committee drafting legislation to loosen restrictions on class actions which will allow for "controlled contingency fees." With contingency fees, lawyers have an economic stake in the outcome of the action. As a result they may be more likely to settle out of court than take the case to trial.[163]

Section 36 of the *Competition Act* should be amended to allow private civil actions for double damages rather than single damages at present. The objective is to increase the incentive for private enforcement[164] by ensuring full recovery of all legal costs; such recovery is greatly limited by the present rules in Canada. Those worried about the possibility of "blackmail" litigation might argue that private actions be limited to cases where the Crown has already obtained a conviction under the *Competition Act*.

Class Actions: Like the U.S., Canada should permit class actions following a criminal conviction under the *Competition Act*. This will require changes in the rules of court which now make it all but impossible to establish a class action (see Ontario Law Reform Commission, 1982). In Quebec, which has permitted class actions for nine years, only 205 cases were launched and in only 10 did the plaintiffs succeed.[165] Class actions, it is argued, provide for the protection of consumers.

Class actions for competition matters were proposed in Bills C-42 and C-13 in 1977 (see Reid, 1978; Prichard, 1979). However, strong opposition from the business community prevented their enactment (Stanbury, 1979b). Like single plaintiff private actions, successful class actions should be entitled to double damages to create sufficient incentives to overcome the rules regarding the awarding of costs in Canada.

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[161] See Trebilcock (1989); Canadian Bar Association (Ontario) (1988).

[162] Beth Marlin, "A contingency plan to raise the stakes in Ontario lawsuits," *Financial Times*, September 25, 1989, pp. 5-6. A study by the Insurance Corporation of B.C. found that contingency fees exceed hourly fees only in cases involving more than $100,000 in damages. Such cases account for less than 20% of civil cases in B.C. On cases involving large sums, contingency fees work out to about 35% versus 25% for hourly billing. Of course, contingency fees place the risk on the lawyer, who, in theory at least, has the best knowledge of a case's prospects before the courts.

[163] For a more comprehensive discussion see Halpern and Turnbull (1983); Dewees, Prichard and Trebilcock (1981).

[164] Mr. Justice Black of the U.S. Supreme Court has referred to the private civil damage action as "a bulwark of antitrust enforcement" *Perma Life Mufflers Inc. v. International Parts Corp.* (1967) 392 U.S. 134 at p. 139.

[165] *Financial Times*, September 25, 1989, pp. 5-6.

Substitute Actions: The *Competition Act* should also be amended to provide for substitute actions in lieu of class actions.[166] This will permit the efficient recovery of excess profits in cases where the victims are many, but the amount per person is insufficient to warrant separate civil actions for damages. While this solution - proposed in Bill C-42 in 1977 - does not compensate the victims of price-fixing agreements, it does prevent "unjust enrichment" (see Reid, 1978). As noted above, a similar measure (*parens patriae*) exists in the U.S. under which state attorneys-general can sue on behalf of a class of numerous persons, each of whom has been damaged a small amount.

6.3 Procedural Issues

Although the number of conspiracy cases (and other types) has been increasing over the past few decades, the absolute number is still small, less than a handful each year. Given the fact that cases may be adjudicated in the courts of 10 provinces and by the Federal Court of Canada, it would be surprising if most judges of the superior courts ever tried more than one conspiracy case in their career. In short, antitrust cases do not clog the court calendars in Canada. It is not surprising, therefore, that few judges have much knowledge of competition law, specifically conspiracy cases. The quality of many of the trial court judgments reflects their lack of experience with such cases. For example, in a number of recent cases judges have held that an agreement whose effect is to raise the average level of prices is not prohibited by S. 45 (previously S. 32) because the accused did not fix a specific price or set of prices (Stanbury, 1989b). Moreover, because they try so few cases personally, many judges have a great deal of difficulty taking even bare cartels very seriously. For example, in the famous *Dredging* case, the Ontario Court of Appeal stated that a conspiracy to rig bids to defraud public authorities brought under the *Criminal Code* "are of a more serious criminal nature than price-fixing conspiracies" prosecuted under the *Combines Investigation Act*.[167] Yet the effects of these actions are the same. Moreover, since 1976 bid-rigging has been illegal *per se* under competition law.

There is another problem with the adjudication of conspiracy and other competition cases. It lies in the generally weak analysis of these cases by judges handling preliminary hearings. In the 1980s five of 36 conspiracy cases ended there (Table 8). In three cases the accused were discharged and the Crown did not prefer an indictment to take the matter to trial. Good cases

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166. Substitute actions provisions were proposed in Bill C-42 in 1977. See Reid (1978) and Prichard (1979). However, very vociferous opposition by business and trade associations prevented their enactment (Stanbury, 1979).

167. *R. v. McNamara et al.* (No. 2) (1981) 56 C.C.C. (2d) 516, at p. 525.

can be killed by poor judicial analyses and prejudicial findings of fact at the preliminary hearing by judges who are, not surprisingly, unfamiliar with this specialized area of the law.[168]

There is a strong case, therefore, for requiring that all criminal competition law cases (excluding misleading advertising and deceptive marketing practices cases of which there was an average of 143 p.a. in the 1980s) be tried in the Federal Court of Canada. Indeed, expertise may be built up more quickly if a subset of judges of the Federal Court Trial Division were assigned to competition cases. Under this approach, both trial and appeal court judges would, within a few years, acquire a substantial amount of experience with conspiracy and other competition cases. There are, of course, several other precedents for having certain specialized legal issues handled by a single court, e.g., admiralty, income tax, and intellectual property matters. In 1986 when the Competition Tribunal was established to handle civil reviewable matters, notably mergers and abuse of dominant position, five members of the Federal Court were made members of the Tribunal and serve on the panels of three (including lay members) that hear civil cases under the *Competition Act* (see Stanbury, 1986).

If this proposal is unacceptable to provincial governments (who are likely to be lobbied strongly by defence counsel desirous of having conspiracy cases tried before local judges), there is an alternative. It is for the federal Attorney General to request his provincial counterparts in each province nominate a subset of superior court judges who will hear all conspiracy (and other major competition) cases launched in the province. In that way they will gain experience and expertise with the *Competition Act*.

In addition, the Crown should consider ending its practice (since the early 1970s) of taking conspiracy (and other criminal competition) cases to a preliminary hearing. The Crown is not required to do so, and the record indicates that reasonable conspiracy cases are being derailed by the judge's lack of experience with such cases. In other words, the Crown's failures at preliminary hearings is a self-inflicted wound for the federal Department of Justice. No doubt defendants and their counsel will protest such a move as being unfair and conducive to surprises during the trial. There is no place in the proper administration of the criminal law for "games" and surprises. Therefore, the Crown should as a matter of routine provide defendants' counsel with copies of documents likely to be submitted in evidence and a list of all witnesses (including experts) that are to be called. The idea is to generate much of the same information that would be adduced during examination-for-discovery phase in civil litigation.

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[168] See, for example, *R. v. Dave Spear Limited et al.* (Unreported preliminary hearing, Supreme Court of Ontario, April 30, 1986; Bureau of Competition Policy mimeo 478-2).

It would appear, however, that if the legislation is amended to make certain types of agreement illegal *per se*, then the problems encountered at preliminary hearings are likely to be far smaller.

7.0 CONCLUSIONS

Canada has had criminal legislation dealing with horizontal restraints of trade (e.g., price fixing) for a century now. The conspiracy provisions have been, and continue to be, a bulwark in the nation's competition policy. The problem is that they are an ambiguous bulwark in a policy that for virtually all of its life has reflected Canadians' ambivalence about the virtues of competition as the primary means of allocating the nation's scarce resources. It seems reasonable to conclude that a law that does not condemn out of hand even naked cartels is perfectly consistent with the values and belief system of those Canadians - including businessmen and their legal advisors - who are able to shape public policy in this area. In Canada - unlike the U.S. - such agreements are illegal only if they are deemed by the courts to have lessened competition "unduly" or increased prices "unreasonably." This idea is closely related to W.L. Mackenzie King's "abuse theory of detriment,"[169] although the conspiracy legislation preceded the first of King's *Combines Investigation Acts* by almost two decades. In other words, it is acceptable for sellers (or buyers) to get together to enhance prices, so long as they do not "abuse" their collective market power by "going too far." This idea stems from Canadians' deference to authority - the willingness to let people said to be more knowledgeable or in positions of authority to have considerable freedom to extract economic advantage from their position so long as they do not act in an unseemly and overly rapacious manner. The willingness of the public to tolerate price fixing is reinforced by the rhetoric of persons in authority, or said to be expert, that it is not possible to create a statute to make certain types of agreements (e.g., price fixing, market allocation and entry barring) illegal *per se*.[170]

A review of the historical record easily leads to the inference that a long succession of federal governments, both Liberal and Conservative, never intended that business rivals be much inconvenienced in their persistent efforts to form agreements to fix prices or to limit competition in other ways. Consider the following points in support of this conclusion:

- The Act of 1889 was made utterly unenforceable by inclusion of the word "unlawfully." It was not removed for 11 years.

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[169] See Skeoch (1966); Gorecki and Stanbury (1984); Ball (1934); Gorecki and Stanbury (1991).

[170] Recall the discussion of the testimony of Lawson Hunter and Mel Cappe in Section 4.2.

- When the law of 1889 was passed, no provision was made for enforcing it other than through investigations by the local police with prosecution by the provincial attorney general. It is surprising that even a few cases were brought under this process. Prosecution lay in the hands of the provincial attorneys general until the late 1940s. Few little aptitude for or interest in prosecuting white collar pillars of the local business community who were engaged in activity that only a minority in the community thought was a serious matter.
- Efforts by the federal government to establish a viable investigation and enforcement process consisted of a series of half-hearted measures whose failure was pre-ordained. The *Combines Investigation Act* of 1910 produced only one investigation and no prosecutions in nine years. Its successor lasted about two years before it was declared unconstitutional in 1921. Some 19 months passed before the second *Combines Investigation Act* was passed. It required that prosecutions be preceded by a public investigation and report which could be ignored (and was in over one-quarter of the cases) by the Crown - even if the permanent or *ad hoc* Commissioner found that a combine existed (Gorecki and Stanbury, 1991). By requiring an appraisal and report stage, the government imposed an unnecessary "filter" on enforcement that persisted until 1976, although it was seldom used after the mid-1960s. The point is, however, that by using lengthy and cumbersome processes, businessmen who fixed prices had more to fear from their legal bills than any conviction and fine by the courts. By lengthening the process, the will of the Crown to prosecute was sapped.
- Despite the perception of informed observers that horizontal restraints have been widespread for most of the century, there have been only 145 public prosecutions. This is about one-twentieth of the number of such cases brought in the U.S. This 20 to 1 ratio excludes the vast number of private actions which are said to account for about 90% of all antitrust cases in the U.S..
- For the first 87 years of competition law in Canada there was no statutory right to bring civil actions following an alleged breach of the criminal provisions. When it was enacted in 1976 it provided only for single damages. The contrast to the U.S. could hardly be greater: private treble damage actions have been available since 1890.
- Not only did Canada not provide for private enforcement of its weak conspiracy law prior to 1976, but it has no provision for either class actions or *parens patriae* actions by provincial or the federal attorney general.[171] No wonder that Canada - by comparison to the U.S. - is virtually a paradise for price fixers. It would be difficult to disprove the proposition that - all things considered - this form of crime "pays" in Canada.

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[171] These were proposed in 1977, but defeated by business' opposition. See Stanbury (1979).

- While the Crown has had a high "success rate" (80% over the entire century, counting "P.O. onlys" as a "win"), the penalties and remedies imposed by the courts have been inadequate in virtually every case. The core penalty has been a fine, but these, to quote one judge, have borne "a close likeness to periodic licensing of illegality." Although the maximum fine was at the discretion of the court from 1952 to 1976, then $1 million to mid-1986, and $10 million since then, the largest fine imposed on a firm in a conspiracy or bid-rigging case is $1 million as of December 1990. The typical fine even in the late 1980s was one-eighth of this amount (Table 7).
- While, in theory, businessmen (and women) can go to jail for fixing prices, none has done so. Indeed, since the 1950s the Crown has only rarely charged individuals - other than the owners of unincorporated (small) businesses.[172] In the U.S. - by contrast - it is now common to charge executives involved in conspiracy cases and over one-third of those convicted are sent to jail for an average of 10 months.
- Since 1971 there have been three notable efforts to eliminate unduly from what is now S.45 of the *Competition Act* (formerly S.32 of the *Combines Investigation Act*). All have failed in the teeth of a gale of criticism by the business community acting through major trade associations. Further, the Canadian Bar Association has lent its prestige and voice to those who have no interest in seeing paradise lost, i.e., the elimination of "unduly." In passing, it should be noted that the legal profession does not come to the debate with entirely clean hands. It fought vigorously (and successfully) in the *Jabour* case[173] to be held exempt from the provisions of the *Combines Investigation Act* on the grounds they were already regulated by a valid provincial statute. Only last year two local law societies in Ontario accepted a consent order (P.O. only) which prohibits them from continuing to fix and enforce specified fees for real property transactions (Hunter, 1988b).
- A review of a century of experience with Canadian competition law makes us aware that major reforms are long overdue. Business' free ride (free lunch?) on conspiracies in restraint of trade must be brought to an end. The "experiment" with the present legislation must be seen without the distortion of rose-coloured glasses. The time has come to call a spade a bloody shovel. The conspiracy provisions of the *Competition Act* and its predecessors have been a failure in terms of protecting the public interest in

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[172] The argument that businessmen whose firms are convicted of price fixing are stigmatized as a result has almost no force in Canada. Perhaps the best illustration is the *McGavin Bakeries* case. The judge excoriated one senior executive in particular as being the driving force behind the cartel which lasted over a decade. Yet this man went on to become Chancellor of the University of B.C.

[173] *Jabour v. Law Society of British Columbia et al.* (1979) 98 D.L.R. (3d) 442 (Trial); (1981) 115 D.L.R. (3d) 549 (Appeal); (1982) 137 D.L.R. (3d) 1 (SCC). See also Stanbury (1983).

having prices determined by competitive market forces.[174] Cartels, like child molesters, have no redeeming virtues from the perspective of consumers, whether households or businesses. Hence I propose a comprehensive set of reforms that will restore consumer sovereignty in the place of producers' ability to fix prices virtually with impunity.

In summary terms, Canada should make the following changes in its competition legislation or policy dealing with horizontal restraints of trade:[175]

1. Make certain agreements among competitors (e.g., price fixing, market sharing, entry barring) illegal *per se* as they are in the U.S. Make all other agreements subject to a "rule of reason" test (perhaps by retaining the word unduly for them).
2. Permit a statutory private right of action for double damages following conspiracy cases (and other criminal offences under the *Competition Act*) in which the Crown has obtained a conviction.
3. Establish rules that would permit class actions (for double damages) following a conviction for conspiracy (or other criminal offences under the *Competition Act*) along the lines as proposed in 1977 in Bill C-42.
4. Permit the Director of Investigation and Research to bring a substitute action as was proposed in 1977 in Bill C-42.
5. Create a new civil reviewable matter to deal with cases of conscious parallelism that is maintained through the use of one or more "facilitating practices."
6. The Crown, as a matter of policy, should propose to the courts, following convictions in conspiracy cases, that fines be imposed on corporations based on the "economic" approach to sentencing, i.e., the fine must be at least several times the estimated economic benefit from the offence to reflect the fairly low probability of not getting caught and other factors.[176]

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[174] I fully appreciate the large role that government, through direct regulation, and other ways, has played in fixing prices and restricting other forms of competition. See Stanbury (1987).

[175] The case for these changes is even stronger should the conspiracy provisions be held to be unconstitutional because they violate the 1982 Charter of Rights and Freedms. If the Supreme Court of Canada requires the Crown to meet a "double intent test" (i.e., to prove not only that the accused intended to enter the impugned agreement, but also that they intended to lessen competition unduly), then the conspiracy provisions (now S.45) would be all but unenforceable - see Facey and Stanbury (1991). A comment on the Trial Court's decision in the Nova Scotia pharmacists case [(1990), 98 N.S.R. (2d) 296] can be found in Hunter (1990b). Comments on the Nova Scotia pharmacists and Quebec pharmacists can be found in Wetston (1991).

[176] In September 1991 a new record fine of $1.7 million was imposed on each of three firms: Union Carbide Ltd., Canadian Liquid Air Ltd. and Liquid Carbonic Inc. They pleaded guilty to price-fixing under S.45 of the *Competition Act*. Canadian Oxygen Ltd., which also pleaded guilty, was fined $700,000. The fines had been proposed by lawyers for the federal government and the

7. The Crown, as a matter of policy, should charge individuals directly involved in price-fixing conspiracies.[177] Upon conviction, also as a matter of policy - as done in the U.S. - the Crown should request short jail sentences of, say, six months duration. This would be a strong form of deterrence to the white collar individuals who may consider such a conspiracy.
8. The Crown should end the practice of taking conspiracy (and other competition) cases to a preliminary hearing. It should, instead, make extensive disclosure of the documents and witnesses to be relied upon in making its case and then proceed directly to trial by a superior court.
9. In order for judges to gain more experience with competition cases, the federal government should seek to have all such cases heard by a subset of judges of the Federal Court of Canada as has been done with respect to civil matters in the *Competition Act*.

In one sense, history is a sunk cost or benefit. Yet there is much to be gained from studying history, including that of competition law and policy in Canada. As George Santayana has reminded us, "those who do not remember the past are condemned to relive it." The centenary of a policy is a particularly appropriate time to learn from its history and to make the necessary changes to escape from the errors of our past.

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defendants' lawyers. See "Union Carbide fined $1.7 million for price fixing," *Globe and Mail*, September 7, 1991, p. B2; "Price-fixing firms pay the penalty," *Globe and Mail*, September 14, 1991, p. B3.

[177] In mid-October 1991 the two top executives of Liquid Carbonic Inc. were each fined $75,000 after pleading guilty to assisting in a price-fixing scheme among companies supplying 97% of the compressed gases sold in Canada. The Crown's lawyer said "we think it's important for individuals to know they can't hide behind corporate coat tails." See "Pair fined $75,000 each for price-fixing role," *Globe and Mail*, October 19, 1991, p. B3; "Big fine warns executives not to fix prices," Vancouver *Sun*, October 19, 1991, p. C4.

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Table 1

COMBINES CASE AND ACTIVITIES, 1888/89 TO 1988/89

Period, fiscal year ending March 31	Combines Prosecutions[1]					Reports or Cases Sent to Attorney General but not Prosecuted	Discontinued Inquiries	Files Opened in Response to Complaints
	Total	Conspiracy[7]	Merger and/or Monopoly	RPM and Ref. to Sell	Other			
1889-1910	10	10	0	na	0	na	na	na
1911-1923	1	1	0	na	0	na	na	na
1924-1940	13	10	1	na	2	17	na	538
1941-1946	3	3	0	na	0	0	na	66
1947-1955	9	6	1	2	0	9	25[2]	794[3]
1956-1960	18	13	2	1	2	6	30	456
1961-1965	19	8	0	10	1	10	77	816
1966-1970	25	16	1	7	1	5	82	579
1971-1975	45	18	4	15	8	19	95	963
1976-1980	72	19	2	47	4	19	74	941[4]
1981-1985	82	18	0	58	6	26	96	1147
1986-1989	62[6]	21	2[5]	38	3	19	71	1152[8]

Notes:

1. Excludes all misleading advertising and deceptive marketing practices cases and 3 patent cases started in 1945/46, 1967/68 and 1969/70. The first dealt with optical goods, the law two, Union Carbide's plastic extrusion and printing patents.
2. 1951-1955 only.
3. 1950/51 - 1954/55 only (542).
4. 1957-1982 figures cover "substantive complaints only, due to change in procedure in Records Office." This changes to files which required two or more days of review beginning in 1982-83.
5. This excludes civil law merger and abuse of dominant position cases brought under the *Competition Act* of 1986. See *Canadian Competition Policy Record*, Vol. 12(1), 1991, p. 9 for civil merger cases in the period June 19, 1986 and March 28, 1991.
6. Excludes merger cases.
7. Dated by month in which the case was completed.
8. Includes merger cases. See also Table 5 in Sanderson and Stanbury (1989).

na = data not available

Sources: Gorecki and Stanbury (1979); Annual Reports of the Director of Investigation and Research; Sanderson and Stanbury (1989) and corrections and updates by the author.

Table 2

NUMBER OF CONSPIRACY CASES IN CANADA AND THE U.S., 1890-1969

Period[1]	Canada	U.S. DOJ[2]	U.S. FTC[3]	Average Fine Per Case in U.S.[4]
1890-94	0	3	nap[5]	no convictions
1895-99	1	7	nap	no convictions
1900-04	3	5	nap	$ 1,000 (1)
1905-09	7	28	nap	$ 21,876 (10)
1910-14	0	62	nap	$ 21,057 (19)
1915-19	0	29	11	$ 11,220 (13)
1920-24	1	50	35	$ 58,835 (13)
1925-29	2	36	9	$ 66,376 (12)
1930-34	7	19	14	$ 20,349 (7)
1935-39	1	34	74	$ 51,936 (17)
1940-44	3	179	64	$ 51,378 (123)
1945-49	1	114	26	$ 35,802 (50)
1950-54	6	122	25	$ 18,711 (64)
1955-59	13	122	22	$ 50,074 (86)
1960-64	7	104	7	$126,557 (62)
1965-69	18	75	4	$116,622 (46)
Total	70	989	290	

1. Dated by day the case was filed (information laid). Note cases in Tables 3 to 5 are dated by date of last proceedings, i.e., when they are completed.
2. Department of Justice.
3. "Horizontal price fixing" cases filed by Federal Trade Commission.
4. Based on all criminal U.S. Dept. of Justice antitrust cases not just conspiracies to fix prices, etc. Figures in brackets are the number of cases in which a fine was imposed. Most cases were conspiracies.
5. nap = not applicable; FTC was not created until 1914.

Sources: Posner (1970, Tables 20, 23, 31) and Tables 3, 4, 5.

Table 3

RESULTS OF CONSPIRACY PROSECUTIONS IN CANADA, 1889 to 1923[1]

	Case, R. v.	Date of Last Proceedings	Level	Plea	No. of Defendants[6]	Result ($ = total fines)
1.	American Tobacco Company of Canada	April 1897	T	NG	1/0	Acquitted
2.	Elliott[3] (Pres. of Ont. Coal Assoc.)	Jan 1905	A	NG	0/1	$4,000
3.	Master Plumbers and Steam Fitters Co-operative Assoc. Ltd. et al.	Mar 1907	A[7]	NG	2/0	$10,000
4.	Armstrong et al.[5]	? 1905	T	G/NG[2]	1/7	fines not available
5.	McKittrick et al.[5]	? 1905	T	G/NG[4]	1/5	fines not available
6.	McGuire et al.	Jan 1906	T	G	0/38	$10,000
7.	McMichael	June 1907	T	NG	0/1	$250 + costs or 3 months jail
8.	Gage et al. (members of Winnipeg Grain Exchange)	? 1908	A	NG	several	Acquitted
9.	Clarke (Pres. of Alberta Retail Lumber Dealers Assoc.)	July 1908	A	NG	0/1	$500
10.	Beckett et al. (Dominion Wholesale Grocers Guild)	Mar 1910	T	NG	2/7	Acquitted
11.	Canadian Wholesale Grocers Assoc. et al.	? 1922	A	NG	5/5	Acquitted[3]

1. All prosecutions were under the *Criminal Code*, S. 520 which was renumbered as S. 498 in 1906 - except #9 which also involved a civil action (application for an injunction) under the *Combines Investigation Act*.
2. Four pleaded guilty to one count and found not guilty on the other. The others were found not guilty on both counts.
3. Held that Attorney General of Ontario had no locus standi to bring a civil action, i.e., application for injunction under the *Act*.
4. Four of the five individuals pleaded guilty. The Association and one individual pleaded not guilty. The individual was acquitted.
5. Case decided at same assizes as #3 but not reported according to Neil MacLeod of the BCP Legal Branch.
6. Corporations (or trade associations)/Individuals (or unincorporated enterprises).
7. Only Central Supply Assoc. appealed.

Sources: Ball (1934), Bladen (1932), Edgar (1906), Stanbury (1976) and the court judgments.

Table 4

RESULTS OF CONSPIRACY PROSECUTIONS[1] IN CANADA, 1923/24 to 1964/65

	Case, R. v.	Date of Last Proceedings	Level	Plea	No. of Defendants[10]	Result ($ = total fines)
1.	Simington et al.[9]	Fall 1926	T	NG	53 total	Charges Dropped under Code and Act but convicted of other offences[2]
2.	Amalgamated Builders Council et al.[9]	June 1930	T	G	1/13	$26,500[11]
3.	Stinson-Reeb et al.	Feb 1932	SCC	NG	3/0	$6000
4.	Singer et al.[9]	June 1931	SCC[3]	NG	0/6	$17,600
5.	Alexander Ltd. et al.[9]	Jan 1932	T	NG	7/15	$26,200
6.	Famous Players et al.[9]	Mar 1932	T	NG	15/3	Acquitted
7.	White et al.[9]	April 1932	T	NG	0/11	$1,100 + 1 year suspended sentence
8.	Chapman et al. (basket pool)[9]	Jan. 1933	T	G	0/15	$1,500
9.	Canadian Import Co. et al.[9]	June 1935	A(d)[6]	NG	5/0	$30,000
10.	Hartt and Adair Coal Co. Ltd. et al.	June 1936	A	NG	5/0	$13,500
11.	Container Materials Ltd. et al. (incl. H.J. Badden)	Feb 1942	SCC	NG	19/1	$159,000
12.	Bathurst Power & Paper et al. (incl. H.J. Badden)	Mar 1942	T	G	4/1	$17,000
13.	Imperial Tobacco Co. of Canada et al.[8]	May 1942	A(d)[7]	NG	27/9	$15,000
14.	Ash-Temple Co. Ltd. et al.	Feb 1949	A	NG	18/0	Acquitted
15.	Hobbs Glass Limited et al.	Oct 1950	T	G	9/0	$44,000
16.	McGavin Bakeries et al.	Oct 1951	T	NG	6/0	$30,000 + $19,402 costs
17.	Goodyear Tire & Rubber Co. of Canada Ltd. et al.	Sept 1953	T[4]	G	5/0	$50,000 + P.O.(G)
18.	Firestone Tire & Rubber Co. of Canada Ltd. et al.	Nov 1953	T	G	9/0	$90,000 + P.O.(G)
19.	Dominion Rubber Co. Ltd. et al.	Nov 1953	T	G	8/0	$80,000 + P.O.(G)
20.	Crown Zellerbach Canada Ltd. et al.	Nov 1956	A	NG[5]	10/0	$58,000 + P.O.(G) + costs
21.	Northern Electric Co. Ltd. et al.	Apr 1956	T	NG	10/0	$82,000 + P.O.(D) + costs
22.	Morrey et al. (Retail Merchants Assoc. of Canada)	June 1956	A(d)	NG	1/30	$1.00 + P.O.; appeal by 26 retailers allowed (4 were found not guilty) (Assoc. pleaded G)
23.	J.W. Fogg et al. (Timmins coal)	Mar 1956	T	NG	2/6	$3650 + P.O.(G)
24.	Dominion Steel & Coal (wire fencing)	May 1956	T	NG	6/0	$60,000 + P.O.(G)

Table 4 - continued

	Case, R. v.	Date of Last Proceedings	Level	Plea	No. of Defendants[10]	Result ($ = total fines)
25.	Howard Smith Paper Mills Ltd. et al.	May 1957	SCC	NG	27/2	$242,000 + P.O.(G)
26.	Berbeck Quilting Co. et al.	Oct 1957	T	G	6/4	$6,000 + P.O.(D) + $500 costs
27.	D.E. Adams et al. (Winnipeg coal)	Nov 1957	T	G	11/11	$20,000 + P.O.(G)
28.	Link-Belt Ltd. et al. (conveyer equipment)	Nov 1957	T	G	7/0	$52,000 + P.O.(G)
29.	Johns Manville et al. (asphalt roofing)	Jan 1958	T	NG	11/0	$110,000 + P.O.(G)
30.	Gair and Hinde & Dauche (boxboard)	Nov 1958	T	G	2/0	$6,000 + P.O.(G)
31.	Bathurst Pulp & Paper et al. (boxboard)	Nov 1958	T	G	12/0	$59,000 + P.O.(G)
32.	Armco et al. (metal culverts)	Nov 1959	T	G	5/0	$65,000 + P.O.(G)
33.	Abitibi et al. (pulpwood)	June 1960	T	NG	17/0	$240,000
34.	Electrical Contractors Assoc. of Ontario	Jan 1961	A(d)	NG	1/0	$7500 + P.O.(D)
35.	Lyons Fuel, Coal, Sault Ste Marie	Sept 1961	T	NG	3/0	$15,500 + P.O.(D)
36.	C.W. Dent (head of Electrical Contractors Association of Ont.)	Nov 1961	T	G	0/1	$7500 + P.O.(D)
37.	Sugar, Eastern Canada	Mar 1963 July 1967	A A	G NG	3/0	$75,000 + P.O.(D) Atlantic Sugar appealed P.O.; appeal dismissed
38.	Belt Mfg. Assoc. of Montreal	Sept 1963	T	G	1/0	$300 + P.O.(D)
39.	Ice Cream Mfg. and Dist. Society of B.C., FVMPA, et al.	May 1964	T	P.O.	10/0	POWC
40.	Civil Const. et al.[8] (sewers and water mains)	Nov 1964	T	G	5/0	$3000 + P.O.(G)

T = Trial
A = Court of Appeal
SCC = Supreme Court of Canada
(d) = Leave to appeal to Supreme Court of Canada was denied.
G = general P.O.
D = detailed P.O.
POWC = Prohibition Order without conviction

Notes:

1. Under the *Criminal Code* of Canada except where noted by footnote 8 or 9.
2. Four firms and four individuals were convicted and each fined $25,000 for fraud and offences under the *Secret Commissions Act* according to Bureau of Competition Policy records.
3. Belyea and Weinraub only. Ultimately, 5 of 6 defendants were convicted.
4. Appealed unsuccessfully to Supreme Court of Canada on the constitutionality of prohibition orders.
5. All the accused but Crown Zellerbach and Bartram pleaded guilty. Their appeal from conviction was dismissed.
6. Found not guilty on merger count.
7. Only one firm (W.C. Macdonald Inc.) which did not appeal was convicted of both conspiracy and one count of monopoly according to BCP records.
8. Charged under the *Combines Investigation Act* only.
9. Charged under the *Combines Investigation Act* and the *Criminal Code*.
10. Corporations (or trade associations)/Individuals (or unincorporated enterprises).
11. Ball (1934, p. 86) states this amount was for ABC and 13 individuals tried in London in May and one individual who pleaded guilty in London in June 1930.

Sources: Derived by the author from reported judgments.

Table 5

CONSPIRACY CASES AND BID-RIGGING CASES COMPLETED BETWEEN 1965/66 AND 1990/91

	Case	Date	Final Level	Plea	No.[1]	Result
1.	Pencils	Mar '66	T	G	4/0	$16,000 + P.O.(G)
2.	Ready-mix, Windsor	Sept '66	T	G	4/0	$13,500[2]
3.	Dump trucks, Brant County	Sept '66	T	NG	1/6[3]	$1000 + P.O.(D)
4.	Paperboard cartons (S.498(1)(d))	Dec '66	T	G	20/0[4]	$391,500 + P.O.(D)
5.	Linen supply, Montreal	Mar '67	T	NG	18/4	$17,500 + P.O.(D)
6.	Street/road paving, Hull	Mar '67	T	G	6/0	$9000 + P.O.(G)
7.	Eastern sugar	July '67	A	G	3/0	$75,000 + P.O.[5]
8.	Road surfacing, Ontario	Nov. '67	A(d)[6]	NG	12/0	Acquitted (services held to be exempt)
9.	Plumbing supplies, Alta (S.411(1)(c))	Apr '68	T	G	8/6[7]	$64,000 + P.O.(G)
10.	Laminated beams	May '68	T	G	4/0	$12,500 + P.O.(G)
11.	Mandarin oranges, Vancouver	May '68	T	NG	10/0	$98,500 + P.O.(D)
12.	Craig Plumbing et al.	Oct '68	T	G	12/0	$32,500 + P.O.(G)
13.	Emco Ltd. et al.	Oct '68	T	G	5/0	$25,000 + P.O.(G)
14.	Meat packing, N.B.	June '69	T	G	3/4	$15,800
15.	Lathing & plastering, Toronto	Nov '69	T	G	11/0	$75,000 + P.O.(D)
16.	French lang. books, Quebec	Jan '70	T	PO	32/0	POWC[8](D)
17.	Dairies, Montreal	Apr '70	T	PO	11/0	POWC(D)
18.	Resilient flooring, Toronto	Apr '70	T	G	12/0	$20,400 + P.O.(D)
19.	J.W. Mills et al.	June '70	SCC	NG	3/0	$20,000 + P.O.(D)
20.	BC pharmacists	Nov '70	T	NG	2/0	$10,000[9]
21.	Roofing contr. (insulation), Vancouver	May '71	T	PO	12/0	POWC(D)
22.	Retail gasoline dealers assoc., Nova Scotia	June '71	T	PO	1/0	POWC(D)
23.	Stove oil, Salmon Arm	May '71	T	PO	2/4	POWC(D)
24.	Ready mix concrete, Toronto	April '72	T	G	12/0	$245,000 + P.O.
25.	Building supplies, Toronto	June '72	T	PO	14/0	POWC(D)
26.	Sherwin Williams and Chipman Chemicals	Sept '72	T	PO	2/0	POWC(D)
27.	Canada Cement Lafarge Ltd. et al.	Sept. '73	Prel	NG	4/0	Discharged
28.	Quebec Tavern Assoc.	Dec. '73	T	G	1/0	$250 + P.O.
29.	Dairies, Sudbury	Feb '74	Prel	NG	4/0	Discharged
30.	Lumber, Toronto	June '74	T	G	13/0	$144,700 + P.O.(D)
31.	Cement, Vancouver	Dec '74	T	G	3/0	$250,000 + P.O.(D)
32.	Ready mix, Vancouver	Dec '74	T	G	4/0	$137,000 + P.O.(D)
33.	Ready mix, Vancouver	Dec '74	T	G	2/0	$45,000 + P.O.(D)
34.	Medical gases	Mar '75	A	NG	4/0	Dismissed applic. for POWC[10]
35.	Auto body parts, Nfld	June '75	T	G	7/0	$32,000 + P.O.
36.	Fur dressing industry	Feb '76	T	G	6/0	$5200 + P.O.
37.	Bread, Quebec	Mar '76	T	G	1/3	$2000 + P.O.
38.	Allied Chemical & Cominco[11]	Mar '76	A	NG	2/0	Acquitted

Table 5 - continued

	Date	Final Level	Plea	No.	Result
39. Armco et al. (culverts)	Apr '76	A(d)	NG	10/0	$447,000 + P.O.
40. Alcan et al. (extruded alum.)	Nov '76	T	NG	5/0	Acquitted
41. Gasoline, Moncton	Dec '76	T	PO	1/5[12]	POWC
42. Anthes Business Forms et al.	Feb '77	A	NG	13/1	Acquitted
43. Large lamps	Apr '77	T	NG	3/0	$550,000 + P.O.
44. Aetna Insurance et al.	Apr '77	SCC	NG	73/0	Acquitted
45. Gasoline, Castlegar	Oct '77	T	PO	0/13	POWC
46. Taxi cabs, Chatham NB	Apr '78	T	PO	0/5	POWC
47. Domtar et al., wallboard	May '78	T	G	3/0	$275,000 + P.O.
48. Barton Tubes et al.	Oct '78	T	G	8/1[13]	$220,000 + P.O.
49. Concrete blocks, Lethbridge	Dec '78	Prel	NG	2/0	Stay of proceedings[14]
50. Ready-mix, Lethbridge	June '79	T	NG	2/0	Acquitted
51. Gasoline, Sydney	Nov '79	T	PO	0/4	POWC
52. Cominco et al., fertilizer	Jan '80	T	NG	6/0	Acquitted
53. Autoparts, Port Alberni	Mar '80	SCC	NG	5/0	Acquitted
54. Golf equipment	June '80	T	G	2/0[15]	$50,000
55. BCTV et al.	July '80	T	NG	10/6	Acquitted
56. Atlantic Sugar et al.	July '80	SCC	NG	4/0	Acquitted
57. Acme Sanitation et al.	Oct '80	T	NG	3/0	Acquitted
58. Paradichlorbenzene	Jan '81	Prel	NG	3/0	Discharged
59. Insurance fees, Quebec	Mar '82	A	NG	2/0[16]	Acquitted
60. Travelways et al. (bid rig)	May '82	A	NG	4/0	$52,000
61. Goodwill Bottling et al.	May '82	T	G	3/1[11]	$100,000 + P.O.
62. Conference interpreters, Quebec	June '82	Prel	NG	0/6	Discharged
63. Quebec concrete	Feb '83	T[17]	G	4/0	$465,000 + P.O.
64. Albany Felt et al.	Feb '83	A(d)	NG	6/0	$545,000 + P.O.
65. VW parts, Vancouver	82/83	Prel	NG	6/0	Stay of proceedings[14]
66. Heating equip., Alta (bid rig)	Sept. '83	A	NG	3/0	$21,000
67. Uranium marketing	Dec '83	Prel	NG	6/0	Stay of proceedings[18]
68. Household moving companies	Dec '83	T	G	6/0[19]	$250,000[2] + P.O.
69. Thomson Newspapers et al.	Feb '84	T	NG	3/0	Acquitted[20]
70. Diesel gen. units (bid rig)	Dec '84	T	G	2/0	$32,500
71. Outdoor advertising	Feb '85	T	G	3/0	$700,000[21] + P.O.
72. Steel, Quebec (bid rig)	June '85	T	G	5/0	$42,000 + P.O.
73. Fruit growers, B.C.	June '85	T	NG	7/6[22]	Acquitted
74. Gasoline, Rouyn	Oct '85	T	PO	0/17	POWC
75. Pharmacists, Toronto	1985/86	T	NG	1/7[23]	Acquitted
76. Fencing, Alta (bid rig)	Jan '86	T	NG	2/0	Acquitted
77. Autobody shops, Ft. Erie	Apr '86	Prel	NG	4/0	Discharged
78. Driving schools, Sherbrooke	Oct '86	T	G	4/0	$5000 + P.O.
79. Coastal Glass et al. (bid rig)	Oct '86	A	NG	3/0	$85,000[24]
80. Reprographic services (bid rig)	Nov '86	T	G	3/0	$120,000 + P.O.

Table 5 - continued

		Date	Final Level	Plea	No.	Result
81.	Hotels, Ottawa	Apr '87	T	G	6/0	$420,000 + P.O.[28]
82.	Aluminum siding, Kamloops	May '87	T	PO	10/0	POWC
83.	Waterloo Law Assoc.	Jan '88	T	PO	1/0	POWC
84.	Kent County Law Assoc.	Jan '88	T	PO	1/0	POWC
85.	Gaspe cure fish	1987/88	T	G	11/0	$11,000 + P.O.
86.	Hogs, Alberta	Feb '88	T	G[25]	5/0	$475,000 (for 4 firms pleading guilty)
87.	Trucking, Western Canada	Mar '88	T	PO	20/11[26]	POWC
88.	School buses, Quebec	Apr '88	T	G	1/0	$23,000 + P.O.
89.	Business forms, Sask. (bid rig)	June '88	T	G	4/8[27]	$1,560,000 + P.O.
90.	Printed forms, Nova Scotia (bid rig)	June '88	T	G	2/0	$400,000 + P.O.
91.	Real estate brokerage industry	Dec '88	T	PO	10/0	POWC (but covers all 115 real estate boards in Canada)
92.	Soft drinks, Manitoba	Jan '89	T	G	3/0	$240,000 + P.O.
93.	Architectural hardware (bid rig)	Sept '89	T	PO	4	POWC
94.	Flour milling (bid rig)	Dec '90[29]	T	G	7	$3,405,000
				PO	1	POWC

PO = Prohibition Order
(d) = leave to appeal to SCC denied
T = Trial Court
G = General P.O.
A = Court of Appeal
D = Detailed P.O.
SCC = Supreme Court of Canada
POWC = Prohibition Order without conviction

Notes:

1. Corporations or trade associations/individuals or unincorporated businesses.
2. Prohibition Order was refused by the court.
3. Originally charged 6 individuals and 1 trade association; two individuals acquitted; Crown did not offer evidence against the other four so they were dismissed.
4. Two firms pleaded not guilty, were convicted and appealed. The Crown appealed the fines and P.O.; both appeals were unsuccessful in March 1969.
5. Three sugar refiners pleaded guilty and were fined $25,000 each in March 1963. A P.O. was also imposed. Atlantic appealed the P.O. and it was allowed on technical grounds in July 1964. The Crown applied for another P.O. which was granted in December 1965. Atlantic appealed unsuccessfully.
6. Notice of appeal to SCC was quashed.
7. Six individuals charged but nolle prosequi entered; then a P.O. was obtained against 2 individuals in 1968/69.
8. Two P.O.s were granted, one against sellers of French language books generally and the other re textbooks.
9. One pharmaceutical association acquitted and one convicted.
10. The Crown's request for a P.O. was refused. The Quebec Court of Appeal dismissed the appeal 2:1.
11. Charges against an individual were dropped.
12. Managing director and executive officers of the Maritime Retail Gasoline Assoc. (exact number not given).
13. Includes one individual and 1 company who were discharged at the preliminary hearing.
14. Ordered to stand trial at the Preliminary Hearing but Dept. of Justice decided not to prosecute.
15. Two associations of professional golfers.
16. Both were associations of insurance agents.
17. S.33 (monopoly) charge was dropped.
18. The two Crown corporations sought an order prohibiting a provincial court from proceeding with a preliminary inquiry. The Supreme Court of Canada upheld the lower courts' decisions prohibiting the Attorney General from proceeding against the Crown corporations as they had Crown immunity in this case. The Crown stayed proceedings against the private firms.
19. Charge against Canadian Warehousing Assoc. withdrawn; the Canadian Household Goods Carriers' Tariff Bureau Assoc. was convicted. Only the 5 firms were fined.
20. Also charged under S.33 (merger and monopoly); also acquitted on those charges.
21. Including a fine of $400,000, the largest in any S.32 case.
22. Includes 7 growers' coops/associations and 6 individuals.
23. 7 individuals and 1 association.
24. Only 1 firm was convicted.
25. On Dec. 9/83 three firms pleaded guilty and were each fined $125,000. One firm pleaded guilty and was fined $100,000 on Feb. 23/88. On Jan. 15/88 Canada Packers was acquitted on both charges. The Crown abandoned its appeal.
26. 20 trucking companies; 11 individuals in original indictment which was quashed.
27. Four individuals were discharged at the preliminary hearing; charges were dropped against four other individuals.
28. The bid-rigging charges were dropped.
29. 4 firms tried in December 1990; 2 in January 1991; 1 in April 1991; and 1 (POWC) in June 1991, but all from the same case investigation.

Sources: Compiled from *Annual Reports* of the Director of Investigation and Research, Bureau of Competition Policy, Ottawa.

Table 6

RESULTS OF CONSPIRACY AND BID-RIGGING CASES IN CANADA, 1889 TO 1990/91

	Years Ended March 31[5]											
Disposition	1889-1910	1911-1923	1924-1940	1941-1950	1951-1955	1956-1960	1961-1965	1966-1970	1971-1975	1976-1980	1981-1985	1986-1991
Total cases referred to the Attorney General of Canada	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	15	23	27	26	21
Cases not prosecuted	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	0	6	8	7	3+[4]
Results of Prosecutions												
Non Convictions	3	1	1	1	0	0	0	1	3	8	9	4
- Charges Dropped/Stay of Proceedings	0	0	0	0	0	0	0	0	0	1	2	0
- Dismissed at Preliminary Hearing	0	0	0	0	0	0	0	0	2	0	2	1
- Acquitted at Trial/Appeal	3	1	1	1	0	0	0	1	1	7	5	3
Convictions (or POWC)	7	0	9[3]	3	5	13	8	15	15	11	11	19
- Prohibition Order without conviction	nap	nap	nap	nap	0	0	1	1	6	4	0	7
- Fine only[1]	7(1)[2]	0	9(2)	3(1)	2(1)	1	1	2(2)	1(0)	0	4(2)	3(2)
- Fine and Prohibition Order[1]	nap	nap	nap	nap	3(3)	12(6)	6(4)	12(9)	8(7)	7(5)	5(4)	9(9)
Success rate (excl. cases where charges were dropped)	70%	0%	80%	75%	100%	100%	100%	94%	83%	61%	56%	83%
Guilty plea rate (excluding POWC cases)	10%	0%	20%	25%	80%	46%	57%	85%	78%	71%	67%	92%

POWC = Prohibition Order without conviction

[1] Number in brackets is the number of guilty pleas.
[2] In two other cases some accused pleaded guilty and others pleaded not guilty.
[3] Includes *R. v. Simington* (1926) where the charges were dropped under the *Act* and the *Code*, but a conviction was obtained under the *Secret Commissions Act*. The result was attributable to the investigation under the *Combines Investigation Act* (see Ball, 1934).
[4] No data on cases not prosecuted for 1987/88 or 1989/90 or 1990/91.
[5] Cases are dated by the date of the last proceedings.

Sources: Compiled from Gorecki and Stanbury (1991) and from data in the *Annual Reports* of the Director of Investigation and Research, Bureau of Competition Policy.

Table 7

FINES IMPOSED IN CONSPIRACY AND BID-RIGGING CASES IN CANADA, 1889 TO 1990/91

(in nominal dollars)

Period[1]	No. of Cases (convictions)	Average no. of firms and/ or individ. convicted per case	Average fine per case	Average fine per firm or individ.	Range of fines per firm or individual
1889 to 1910	5[2]	8.6	$ 5,756	$ 576[6]	$100 to $5000
1911 to 1923		only one prosecution and it was not successful			
1924 to 1942	11[3]	9.7	$ 28,491	$ 2,929[7]	$100 to $10,000
1943 to 1949		only one prosecution and it was not successful			
1950/51 to 1954/55	5	7.4	$ 58,800[4]	$ 7,946[8]	$100 to $15,000
1955/56 to 1959/60	13	10.2	$ 58,742	$ 5,742[9]	$1 to $10,000
1960/61 to 1964/65	7	4.4	$ 49,829	$ 11,252	$300 to $25,000
1965/66 to 1969/70	14	8.1	$ 60,486	$ 7,494	$100 to $10,000
1970/71 to 1974/75	9	5.7	$ 96,928	$ 17,105	$250 to $125,000
1975/76 to 1979/80	7	5.6	$ 218,743	$ 39,262	$500 to $300,000
1980/81 to 1984/85[5]	9	3.5	$ 246,167	$ 69,234	$2 to $400,000
1985/86 to 1990/91[10]	12	4.5	$ 565,500	$125,667	$1,000 to $1,000,000

1. Cases dated by month of last proceedings, e.g., appeal decision.
2. Excludes two cases for which the fines could not be determined.
3. Excludes *R. v. Simington* convicted and fined under the *Secret Commissions Act* after combines charges were dropped (1926) 45 C.C.C. 249.
4. Excludes $19,402 in costs levied in *McGavin Bakeries* case.
5. Includes 3 bid-rigging cases.
6. 41 of 43 defendants were individuals or unincorporated businesses.
7. 63 of 107 defendants were individuals or unincorporated businesses.
8. 37 defendants, all firms.
9. 20 of 132 defendants were individuals or unincorporated firms.
10. Includes 7 bid rigging cases.

Sources: Computed from data in Tables 3, 4, 5 and data provided by Bureau of Competition Policy.

Table 8

FINAL LEVEL OF CONSPIRACY AND BID-RIGGING CASES IN CANADA, 1889 TO 1990/91

Period	Preliminary Hearing	Trial Court[1]	Appeal Court	Leave to appeal to SCC denied	Supreme Court of Canada[3]	Total
1889 - 1910	0	6	4	0	0	10
1911 - 1912	0	0	1	0	0	1
1923 - 1942	0	7	1	2	3	13
1943 - 1949	0	0	1	0	0	1
1950 - 1955[2]	0	5	0	0	0	5
1956 - 1960	0	10	1	1	1	13
1961 - 1965	0	6 (1)	1	1	0	8
1966 - 1970	0	14 (1)	1	0	1	16
1971 - 1975	2	14 (6)	1	0	1	18
1976 - 1980	1	13 (4)	2	1	2	19
1981 - 1985	4	9 (0)	3	1	1	18
1986 - 1991	1	21 (7)	1	0	0	23
Total	8	105	18	6	8	145

1. Includes cases ending in a Prohibition Order without conviction (POWC) in brackets.
2. 1949/50 to 1954/55 etc.
3. Excludes constitutional cases.

Sources: Compiled by the author from reported judgments and Director of Investigation and Research's *Annual Reports*.

Figure 1

OFFICIAL/ORGANIZATION WITH PRIMARY RESPONSIBILITY FOR ENFORCEMENT OF CANADIAN COMPETITION LAW

1889-1910:	Attorneys General of the provinces
1910-1919:	Under the *Combines Investigation Act* six citizens could apply to a judge, who, if the complainants established a *prima facie* case, could order that an ad hoc Board of Investigation be convened. They had investigatory powers and prepared a public report. Penalty only if combine continued after the Board's report was published and it had found there was a combine. Regular prosecutions were to be conducted by provincial Attorneys General for conspiracy cases under the *Criminal Code*.
1919-1921:	A permanent federal body, the Board of Commerce, had power to investigate allegations of a combine and to authorize prosecutions under both the *Criminal Code* and *Board of Commerce Act*. Prosecution was by provincial Attorneys General.
1923-1935:	Permanent federal official, the Registrar (with Special Commissioners), had the power under the *Combines Investigation Act* to investigate and refer cases to a provincial or to the federal Attorney General.
1935-1937:	Permanent federal body, the Dominion Trade and Industry Commission, had the power to investigate combines and had to authorize prosecutions under the *Criminal Code* and *Combines Investigation Act*.
1937-1952:	Permanent federal official, Commissioner (with Special Commissioners), had the power to investigate combines and refer cases to a provincial or federal Attorney General for prosecution.
1952-1986:	Permanent federal official, Director of Investigation and Research (DIR), to investigate alleged competition offences on own volition or upon receiving a complaint. Restrictive Trade Practices Commission (RTPC) created with responsibilities of approving use of formal investigatory powers by DIR, and conducting an appraisal of evidence in a public report. DIR could after 1960 refer cases directly to the federal Attorney General for prosecution. (From 1976 to 1986 the RTPC also acted as adjudicator for civil reviewable matters, e.g., exclusive dealing.)
1986 - :	Permanent federal official, DIR, to investigate both criminal and civil matters (e.g., mergers) under the *Competition Act*. DIR refers criminal cases to federal Attorney General for prosecution. He may apply directly to the quasi-judicial Competition Tribunal for an order in civil matters (e.g., mergers or abuse of dominant position).

Sources: Gorecki and Stanbury (1991); Ball (1934); Reynolds (1940); Rosenbluth and Thorburn (1963); Gorecki and Stanbury (1979); Gorecki (1981).

Figure 2

SUMMARY CLASSIFICATION OF ALL NON-CONVICTIONS IN CONSPIRACY CASES IN CANADA, 1889 - 1990/91

A. No illegal agreement:

1. *R. v. American Tobacco Co. of Canada* (1897) 3 Rev. de Jur. 453
2. *R. v. Famous Players Canadian Corp Ltd. et al.* (1932) 53 C.C.C. 50 (Trial)
3. *R. v. Canada Cement Lafarge Ltd. et al.*, (1973) 12 C.P.R. (2d) 12
4. *R. v. Aluminum Co. of Canada Ltd. et al.* (1976) 29 C.P.R. (2d) 183
5. *R. v. Atlantic Sugar Refiners Co. Ltd. et al.* (1975) 26 C.P.R. (2d) 14 (Trial); (1978) 41 C.C.C. (2d) 209 (Appeal); (1981) 54 C.C.C. (2d) 373 (SCC)
6. *R. v. Cominco Ltd. et al.* (1980) 46 C.P.R. (2d) 154
7. *R. v. Lethbridge Concrete Products and Revelstoke Companies Ltd.* (1981) 52 C.P.R. (2d) 85
8. *R. v. Thomson Newspapers Ltd. et al.* (Unreported decision of the Supreme Court of Ontario, Toronto, December 9, 1983)
9. *R. v. Dave Spear Limited et al.* (Unreported preliminary hearing, Supreme Court of Ontario, April 30, 1986; Bureau of Competition Policy mimeo 478-2)
10. *R. v. McLellan Supply and S.F. Scott Mfg Co. Ltd.* (acquitted of bid-rigging) (Unreported, see the Director's *Annual Report* for 1985/86, pp. 32-33)

B. Agreement, but not an undue lessening of competition (or no public detriment)

1. *R. v. Gage et al.* (1907) 13 C.C.C. 415 (Trial); (1908) 13 C.C.C. 428 (Appeal)
2. *R. v. Beckett et al.* (1910) 15 C.C.C. 408
3. *R. v. Allied Chemical Canada Ltd. & Cominco Ltd.* (1975) 24 C.P.R. (2d) 22 (Trial); (1976) 73 D.L.R. (3d) 767 (Appeal)
4. *R. v. Anthes Business Forms Limited et al.* (1974) 16 C.P.R. (2d) 216 (Trial); (1975) 20 C.P.R. (2d) 1 (Appeal); (1977) 28 C.P.R. (2d) 33 (SCC)
5. *R. v. Aetna Insurance Company et al.* (1974) 16 C.P.R. (2d) 116 (Trial); (1975) 23 C.P.R. (2d) 231 (Appeal); (1977) 30 C.P.R. (2d) 193 (SCC)
6. *R. v. Chatwin Motors Limited et al.* (1978) 37 C.P.R. (2d) 156 (Trial); (1978) 7 B.C.L.R. 171 (Appeal); (1980) 2 S.C.R. 64 (SCC)
7. *R. v. Browning-Ferris Industries of Winnipeg* (1974) Ltd. et al. (1981) 56 C.P.R. (2d) 257 (Man. Q.B.)
8. *R. v. B.C. Television Broadcasting System Ltd. et al.* (1981) 52 C.P.R. (2d) 47 (BCSC)
9. *R. v. La Federation des Courtiers D'Assurance du Quebec*, Unreported decision of the Quebec Superior Court, District of Saguenay, April 20, 1979; Bureau of Competition Policy mimeo 229-1 (unofficial translation); Unreported judgment of the Quebec Court of Appeal March 30, 1982
10. *R. v. Simone Tanner et al.* (Unreported judgment at a Preliminary hearing in Montreal, June 17, 1982)
11. *R. v. Metropolitan Toronto Pharmacists Association et al.* (1984) 3 C.P.R. (3d) 222 (Ont HCJ)
12. *R. v. British Columbia Fruit Growers Association* (1985) 11 C.P.R. (3d) 183 (BCSC)

Figure 2 - continued

C. Decided on other grounds

1. *A-G of Ontario v. Canadian Wholesale Grocers Association* (1922) 52 O.L.R. 536 (Trial); (1922) 53 O.L.R. 627 (Appeal) (AG for Ontario has no authority to obtain an injunction, i.e., a civil remedy)
2. *R. v. Ash-Temple Co. et al.* (Unreported trial decision of the Supreme Court of Ontario on March 18, 1948); (1949) 93 C.C.C. 267 (Appeal) (evidentiary issue)
3. *R. v. J.J. [K.J.] Beamish Construction Co. Ltd. et al.* ([1966] 1 O.R. 867 (Trial); [1968] 1 O.R. 5 (Appeal)) (held that road surfacing was a service and that services were exempt from the Act)
4. *Medical Gases* (1974/75, *Annual Report*) (application for P.O. only was dismissed on technical grounds)

D. Reason for acquittal can't be determined

1. Dairies, Sudbury (Unreported judgment of a Preliminary hearing, Sudbury, February 1974)
2. *R. v. Chemicals Refineries Corporation et al.* (Unreported judgment at a Preliminary hearing, Montreal, January 21, 1981)

E. Stay of Proceedings

1. Concrete blocks, Lethbridge (December 1978)
2. VW auto parts (1982/83, *Annual Report*)
3. *R. v. Uranium Canada Ltd.* (uranium) (1982), 38 O.R. (2d) 130; (1982) 39 O.R. (2d) 474 (Appeal); (1983), 4 D.L.R. (4th) 193 (S.C.C.) (December 1983)

Source: Tabulation by the author.

Appendix A

CHRONOLOGY REGARDING THE CONSPIRACY PROVISIONS UNDER CANADIAN COMPETITION LAW, 1888-1990

1889: The Parliament of Canada enacted *An Act for the Prevention and Suppression of Combinations formed in Restraint of Trade* (52 Victoria, c.41). The preamble of the 1889 Act stated "whereas it is expedient to declare the law relating to conspiracies and combinations formed in restraint of trade."

The substantive section of the 1889 Act read, in part, as follows.

> 1. Every person who conspires, combines, agrees or arranges with any other person, or with any railway, steamship, steamboat or transportation company, unlawfully,
>
> (a) to unduly limit the facilities for transporting, producing, manufacturing, supplying, storing or dealing in any article or commodity which may be a subject of trade or commerce; or -
>
> (b) to restrain or injure trade or commerce in relation to any such article or commodity; or -
>
> (c) to unduly prevent, limit, or lessen the manufacture or production of any such article or commodity, or to unreasonably enhance the price thereof;or -
>
> (d) to unduly prevent or lessen competition in the production, manufacture, purchase, barter, sale, transportation or supply of any such article or commodity, or in the price of insurance upon person or property.
>
> Is guilty of a misdemeanour and liable, on conviction, to a penalty not exceeding four thousand dollars and not less than two hundred dollars, or to imprisonment for any term not exceeding two years; and if a corporation, is liable on conviction to a penalty not exceeding ten thousand dollars and not less than one thousand dollars. (Quoted in Ball, 1934, pp. 8-9; emphasis added by Ball.)

1892: The Act of 1889 was incorporated into the first *Criminal Code* as section 520 (55-56 Victoria, c. 29). It was to become linked to S. 516 which stated that "a conspiracy in restraint of trade is an agreement between two or more persons to do or procure to be done any unlawful lact in restraint of trade." See Gosse (1962, pp. 81-82).

1897: The *Customs Tariff Act* was amended (S. 18) such that when the Cabinet believed that a combine had unreasonably enhanced the price of an article or unduly promoted the advantage of the manufacturer at the expense of the consumer, it might order an investigation by a judge. If the report found a combine and if the disadvantage to consumers was facilitated by the tariff, the Cabinet could reduce or remove the duty (60-61 Victoria, c. 16). The 1897 provision was used only once, in 1902, in respect to newsprint. The tariff was reduced from 25 percent to 15 percent (Ball, 1934, pp. 14-16). There was only 1 prosecution prior to 1903, *R. v. American Tobacco of Canada*, (1897) 3 *Rev. de Jur.* 453 (acquitted).

1899: A private member's bill (Mr. Sproule, Liberal) to delete "unduly" and "unreasonably" was enacted as the *Criminal Code Amendment Act*, 1899 (62-63 Victoria, c. 46).

1900: Both "unduly" and "unreasonably" were restored in S.520 (July 18, 1900) in *Criminal Code Amendment Act*, 1900 (63-64 Victoria, c.46). Bliss (1973, pp. 183-184) claims that is was, "by accident" that the Senate deleted the world "unlawfully." In any event, the effect was to give the law some teeth.

1903: The first successful prosecution under the 1889 legislation was *R. v. Elliott*, April 1903. It was upheld on appeal. See (1905) 9 C.C.C. 505 which contains both the trial and appeal court judgments. The maximum fine of $4,000 (for an individual) was imposed. Osler J.A.'s discussion of the significance of the amendments of 1900 (pp. 519-520) is particularly helpful.

1906: Sections 516, 517, 520 of the *Criminal Code* were renumbered as S. 496, 497, 498 (63-64 Victoria, c. 46, s. 3).

1907: The *Customs Tariff Act* was amended by repealing S. 18 and a new S. 12 inserted. It was largely the same as the 1897 provision, but it also gave the Cabinet the power to reduce or remove tariffs if a court found a combine under the *Criminal Code*. In 1910 a version of this provision was incorporated into the *Combines Investigation Act* as S.21. It was also incorporated into the *Combines Investigation Act* of 1923.

1910: W.L. Mackenzie King, Sir Wilfrid Laurier's Minister of Labour, introduced the first *Combines Investigation Act* which came into effect May 4. A combine was defined in S.2(c) as

> any contract, agreement, arrangement or combination which has or is designed to have, the effect of increasing or fixing the price or rental of any article of trade or commerce or the cost of the storage or transportation thereof, or of the restricting competition in or of controlling the production, manufacture, transportation, storage, sale or supply thereof, to the detriment of consumers or producers of such article of trade or commerce and includes the acquisition, leasing or otherwise taking over, or obtaining by any person to the end aforesaid, of any control over or interest in the business, or any portion of the business, of any person, and also includes what is known as a trust monopoly or merger...

The Act's full title, *An Act to Provide for the Investigation of Combines, Monopolies and Mergers* is important. The key word is investigation. The Act provided for a formal process for investigation, i.e., six citizen application to a Judge to appoint an *ad hoc* Board of Investigation. The firm(s) under investigation to appoint one person to the Board,the six citizens to appoint one person, the Chairman to be agreed upon or appointed by the judge. (This came from King's *Industrial Disputes Investigation Act* of 1907.) The six citizens had, in effect, to establish a *prima facie* case in open court, with the accused able to ascertain the identity of the complainants--who had to have been directly and adversely affected by the alleged combine.

The three person Board was to prepare a report which was sent to the Minister of Labour. It could make "such findings and recommendations as are in accordance with the merits and requirements of the case." If the Board found an offence, the accused had to cease and desist within 10 days after publication of their "judgment" in the *Canada Gazette*--or face a maximum fine of $1,000 per day thereafter (or such period as specified by the Board).

Great emphasis was placed on publicity rather than on prosecution and criminal penalties. Like U.S. Supreme Court Justice Brandeis, Mackenzie King believed sunlight was an effective disinfectant. See Skeoch (1966, pp. 24-26).

1910 to 1919: There was only one investigation under the Act of 1910--of the United Shoe Machinery Corp. The process began November 10, 1910 and as a sequel to a private case decided in 1905 (*U.S.M. Co. v. Brunet et al.* (1905) Que. S.C. 200-217) and which went to the Privy Council (1909) A.C., 330. The Company fought the application for an investigation unsuccessfully at trial and upon appeal (see Ball, 1934, pp. 44-45). The majority of the three person Board found a combine. The Company, however, made some changes in its leasing practices (see Ball, 1934, pp. 46-48).

1916: Under the *War Measures Act* of 1914, the Cabinet passed an Order-in-Council (P.C. 2777) S.2 part 3 of which repealed S. 498 of the *Criminal Code* only insofar as necessaries of life were concerned (staples and ordinary food, clothing, fuel...). Section 498 was reasserted with the important elimination of the words "unduly" and "unreasonably." Section 3 of the Order-in-

Council provided that no person should accumulate necessaries of life beyond the reasonable amount required for home or business (Ball, 1934, p. 51). The Minister of Labour was empowered to make full investigations. Prosecutions could only be conducted with the consent of the relevant provincial Attorney-General. Subsequent orders amended and changed the original Order (Ball, 1934, p. 52).

1919: The *Combines Investigation Act* of 1910 was repealed and replaced by the *Board of Commerce Act* and the *Combines and Fair Prices Act* (effective July 7, 1919).

The Board of Commerce was to be a permanent administration and enforcement body. In other respects it was strikingly similar to the Act of 1910 (Ball, 1934, p. 55). The Board had the power to issue (civil) cease and desist orders for violations of the *Combines and Fair Prices Act* (Cheffins, 1991). Appeal to the courts from its decisions could be made only on matters of law. The Board had to authorize criminal prosecutions under S.498 of the *Criminal Code* (the conspiracy provisions) or under the *Combines and Fair Prices Act*. The Board, therefore, combined investigation, permission for prosecution and adjudication in civil matters--see Ball (1934, Ch. 7). Note--it could on its own initiative start an investigation under the *Combines and Fair Prices Act*.

A combine was defined as

> 2. The expression "combine" is used in this Act with intended relation to articles of commerce, and it shall be deemed to have reference only to such combines, immediately hereinafter defined, as, with relation as aforesaid, have, in the opinion of The Board of Commerce of Canada (or of a single member thereof acting under authority of and for the purposes of section eight of this Act) operated, or are likely to operate, to the detriment of or against the interest of the public, consumers, producers or others, and, limited as aforesaid, the said expression as used in this Act shall be deemed to include, -
>
> (a) mergers, trust and monopolies, so called, and
>
> (b) the relation resulting from the purchase, lease or other acquisition by any person of any control over or interest in the whole or part of the business of any other person, and,
>
> (c) any actual or tacit contract, agreement, arrangement or combination which has or is designed to have the effect of (1) limiting facilities for transporting, producing, manufacturing, supplying, storing or dealing; or (2) preventing, limiting or lessening manufacture or production; or (3) fixing a common price, or a resale price, or a common rental, or a common cost of storage or transportation, or enhancing the price, rental or cost of article, rental, storage or transportation; or (4) preventing or lessening competition in, or susbtantially controlling, within any particular district, or generally, production, manufacture, purchase, barter, sale, transportation, insurance or supply; or (5) otherwise restraining or injuring commerce.

1920: The Supreme Court of Canada split evenly on the constitutionality of the 1919 legislation, but on appeal it was struck down as *ultra vires* by a unanimous Privy Council. See *Re Board of Commerce Act* (1920), 60 S.C.R. 456; [1922] 1 A.C. 191 (P.C.).

1923: The second *Combines Investigation Act* is passed (again sponsored by W.L. Mackenzie King, now Prime Minister) and came into effect on June 13, 1923. A combine was defined in S.2 as follows

> In this Act, unless the context otherwise requires,
>
> (1) combines which have operated or are likely to operate to the detriment or against the interest of the public, whether consumers, producers or others, and which
>
> (a) are mergers, trusts or monopolies, so called; or

> (b) result from the purchase, lease, or other acquisition by any person of any control over or interest in the whole or part of the business of any other person; or
>
> (c) result from any actual or tacit contract, agreement, arrangement, or combination which has or is designed to have the effect of
>
> (i) limiting facilities for transporting, producing, manufacturing, supplying, storing or dealing, or
>
> (ii) preventing, limiting or lessening manufacture or production, or
>
> (iii) fixing a common price or resale price, or a common rental, or a common cost of storage or transportation, or
>
> (iv) enhancing the price, rental or cost of article, rental, storage or transportation, or
>
> (v) preventing or lessening competition in, or substantially controlling within any particular area or district or generally, production, manufacture, purchase, barter, sale, storage, transportation, insurance or supply, or
>
> (vi) otherwise restraining or injuring trade or commerce,
>
> are described by the word "combine."

The new Act provided for a permanent federal administrator, the Registrar. Investigations could be initiated in three ways: (a) six citizen applications to the Registrar for an investigation; (b) by the Registrar on his own initiative; and (c) at the direction of the Minister. King accepted an amendment in the Committee of the Whole restricting external complaints to six citizens but only British subjects qualified (House of Commons, *Debates*, May 9, 1923, p. 2617).

Prosecutions were to be undertaken by a provincial Attorney-General to whom the report of the Registrar or Special Commissioner had been referred. The federal government would proceed only if the province did not, and an individual laid an information, which was approved for prosecution by the Cabinet (who passed it on to the Minister of Justice).

With very few changes, the 1923 Act remained in force (excluding the 1935-37 hiatus) until the 1952 amendments.

1935: The *Dominion Trade and Industry Commission Act* was passed by the Conservatives and became effective July 5, 1935 (see Cheffins, 1991). The Dominion Trade and Industry Commission was created to administer the *Combines Investigation Act* and to authorize prosecutions under the *Criminal Code*. The Act was aimed at unfair trade practices, and it was hoped it would achieve "fair merchandising" and high commodity standards. Members of the Tariff Board were to constitute members of the Commission which, administratively, came under the Department of Trade and Industry.

Price and production agreeemnts were permitted under S.14 of the *DTTC Act*:

> 14. (1) In any case where the Commission, after full investigation under the *Combines Investigation Act*, is unanimously of opinion that wasteful or demoralizing competition exists in any specific industry, and that agreements between the persons engaged in the industry to modify such competition by controlling and regulating prices of production would not result in injury to or undue restraint of trade or be detrimental to or against the interest of the public, or where such agreements exist and in the unanimous opinion of the Commission but for their existence wasteful or demoralizing competition would exist in any specific industry, the Commission may so advise the Governor in Council and recommend that certain agreements be approved.
>
> (2) The Governor in Council may, if of opinion that the conclusions of the Commission are well founded, approve of any such agreement, and shall make regulations requiring the Commission to determine from time to time whether the agreement is resulting in injury or undue restraint of trade or is detrimental to the public interest....

Where the Cabinet had approved an agreement under S.14, approval of the Commission was required before a prosecution could be launched under S.498 or S.498A of the *Criminal Code* or Act. The Commission retained jurisdiction over the combines legislation in the *Criminal Code* until the 1946 amendments. It lost administration of the *Combines Investigation Act* in 1937, following the decision of the Privy Council noted below.

A more comprehensive definition of "combine" was incorporated into the DTIC Act. The change was most notable in respect to the creation of definitions for an illegal merger and for an illegal monopoly. [See dissent in *R. v. Morrey* (1956) 26 C.P.R. 55.]

The Senate insisted, and the House concurred, in an amendment which exempted services (see House of Commons, *Debates*, July 4, 1935, p. 4278 and p. 4280 and July 5, pp. 4310-4311).

1937: Part of the *Dominion Trade and Industry Commission Act* (passed in 1935) was held to be *ultra vires* of the federal government's power, i.e., S.14 which permitted industrial agreements to prevent "wasteful" or "demoralizing" competition as authorized by the Commission. Again, the Supreme Court, (1935) S.C.R. 379 and the Privy Council, (1937) A.C. 405; 1 D.L.R. 702, were largely in agreement. Note--the Privy Council upheld the *DTIC Act*, but S.14 was excluded from the reference. On the day of the Supreme Court's ruling, Senator Arthur Meighen exclaimed, "We struggled so much to legitimize combines that we exceeded the Constitution" (Senate, *Debates*, June 17, 1936, p. 525).

The *Combines Investigation Act* was amended again (effective April 10, 1937). Administration of the Act was placed in the hands of a permanent Commissioner (title changed from Registrar), and provision was made for the appointment of *ad hoc* Commissioners to investigate and report to the Minister of Labour (then responsible for the administration of the Act). The Commissioner's ability to initiate investigations on his own was deleted. This change was pushed by R.B. Bennett (House of Commons, *Debates*, April 1, 1937, pp. 2436-2439). The Act was changed to permit the Attorney-General of Canada to bring cases on his own under the *Act* or the *Criminal Code*.

The attempt to (i) increase fines and to include services, and (ii) to provide for separate definitions for merger and monopoly offences were deleted from the Bill by the Senate and House respectively.

1939: The *Wartime Prices and Trade Board* was established on September 3. Commissioner McGregor, former private secretary to Mackenzie King (Registrar between 1925 and 1935 and Commissioner since 1937), was appointed as an Enforcement Administrator. The Maximum Price Regulations came into effect December 1, 1941. The enforcement of the combines legislation was effectively suspended, but not with Parliament's consent (see House of Commons, *Debates*, November 23, 1949, p. 2142). Not until January 1947 was the price ceiling on a wide range of commodities suspended.

1946: Amendments were made to the *Combines Investigation Act* (effective August 31, 1946). The principal substantive change, said Mr. St. Laurent (Minister of Justice), was S.9 which authorized the Exchequer (now the Federal) Court to issue an order revising or cancelling a patent licence or pooling agreements or trade mark agreements where such agreements have been used to the detriment of the public.

At the insistence of Mr. Diefenbaker (then a Conservative MP), the Liberals accepted an amendment permitting individuals to lay an Information, a power they had always had under the *Criminal Code*. (Such prosecutions would then be taken over by the Attorney-General.)

1949: Amendments to the *Combines Investigation Act* became effective December 10, 1949. The first major amendment reaffirmed, in effect, the principle that documents found in the possession of individuals are admissible in evidence against them and extended it to apply to companies and to unincorporated businesses which act through employees. The second major amendment provided that in the case of corporations, prosecutions for combines offences are to be tried by a judge without a jury.

The *Combines Investigation Act* was also changed to provide that the Attorney-General of Canada may institute and conduct proceedings under S. 498 or 498A of the *Criminal Code*, i.e., federal officials were finally given equal status to the provincial Attorney-General. In practice, the provincial officials had asked the federal government to conduct such prosecutions in their name.

1952: A series of amendments were made to the *Combines Investigation Act* and to the *Criminal Code* effective November 1, 1952. Provision was made for Orders of Prohibition: (a) as a sole remedy, and (b) in conjunction with fines, etc. The ceiling on fines in both the *Act* and the *Criminal Code* was removed (except for summary convictions). The functions of the Commissioner were divided between the new Director of Investigation and Research (administration and enforcement) and the new Restrictive Trade Practices Commission (appraisal, report, and authorization for the use of formal investigatory powers). S. 2 defined a combine as

> (a) "combine" means a combination having relation to any commodity which may be the subject of trade or commerce, of two or more persons by way of actual or tacit contract, agreement or arrangement having or designed to have the effect of
>
> (i) limiting facilities for transporting, producing, manufacturing, supplying, storing or dealing, or
>
> (ii) preventing, limiting or lessening manufacture or production, or
>
> (iii) fixing a common price or a resale price, or a common rental, or a common cost of storage or transportation, or
>
> (iv) enhancing the price, rental or cost of article, rental, storage or transportation, or
>
> (v) preventing or lessening competition in, or substantially controlling within any particular area or district or generally, production, manufacture, purchase, barter, sale, storage, transportation, insurance or supply, or
>
> (vi) otherwise restraining or injuring trade or commerce, or a merger, trust, or monopoly, which combination, merger, trust or monopoly has operated or is likely to operate to the detriment or against the interest of the public, whether consumers, producers or others.

1953-54: S.496-498 of the *Criminal Code* were renumbered as S.409-411 (S.C. 1953-54, c. 51).

1959: Both the *Combines Investigation Act* and the *Criminal Code* were amended to (temporarily) exempt the activities of B.C. fishermen. Later, the exemption was made permanent.

1960: The Conservative government introduced a set of amendments to the *Combines Investigation Act* which became effective August 10, 1960. The amendments resulted in the following changes with respect to the conspiracy provisions:

- The DIR was permitted to refer cases directly to the Department of Justice, as well as to RTPC.
- Six limited defences to S.32 (conspiracy) were provided.
- Section 31 (now 30(2)) was clarified to make it obvious that a Prohibition Order could be obtained as the sole remedy after an offence has been committed.
- An exemption was provided for export agreements subject to certain conditions.
- Sections in the *Criminal Code* (i.e., S.409 to 412 which had been renumbered from S.496-498, 498A) were incorporated into the *Combines Investigation Act*, i.e., S.411 of the *Code* (with some modifications) was incorporated into S.32 of the Act. Subsection (b) of S.411 was dropped when the *Criminal Code* was incorporated into S.32--it was "to restrain or injure trade or commerce in relation to any article or commodity." But note that S.32(d) was added, i.e., "to otherwise restrain or injure competition unduly."

- Note that S.22 of the amending act (S.C. 1960 c. 45) provided that the new S.32(1) "shall not be held to operate as new law but shall be construed and have effect as a consolidation and as declaratory of the law as contained in the said section 411 of the *Criminal Code*" except where the two were not in substance the same.

The text of S.32 was as follows:

(1) Everyone who conspires, combines, agrees or arranges with another person
- (a) to limit unduly the facilities for transporting, producing, manufacturing, supplying, storing or dealing in any article,
- (b) to prevent, limit or lessen, unduly, the manufacture or production of an article, or to enhance unreasonably the price thereof,
- (c) to prevent, or lessen, unduly, competition in the production, manufacture, purchase, barter, sale, storage, rental, transportation or supply of any article, or in the price of insurance upon persons or property, or
- (d) to restrain or injure trade or commerce in relation to any article,

is guilty of an indictable offence and is liable to imprisonment for two years.

(2) Subject to subsection (3), in a prosecution under subsection (1) the court shall not convict the accused if the conspiracy, combination, agreement or arrangement relates only to one or more of the following:
- (a) the exchange of statistics,
- (b) the defining of product standards,
- (c) the exchange of credit information
- (d) definition of trade terms,
- (e) co-operation in research and development,
- (f) restriction of advertising, or
- (g) some other matter not enumerated in subsection (3).

(3) Subsection (2) does not apply if the conspiracy, combination, agreement or arrangement has lessened or is likely to lessen competition unduly in respect of one of the following:
- (a) prices,
- (b) quantity or quality of production,
- (c) markets or customers, or
- (d) channels or methods of distribution,

or if the conspiracy, combination, agreement or arrangement has restricted or is likely to restrict any person from entering into or expanding a business in a trade or industry.

(4) Subject to subsection (5), in a prosecution under subsection (1) the court shall not convict the accused if the conspiracy, combination, agreement or arrangement relates only to the export of articles from Canada.

(5) Subsection (4) doees not apply if the conspiracy, combination, agreement or arrangement
- (a) has resulted or is likely to result in a reduction or limitation of the volume of exports of an article;
- (b) has restrained or injured or is likely to restrain or injure the export business of any domestic competitor who is not a party to the conspiracy, combination, agreement or arrangement;
- (c) has restricted or is likely to restrict any person from entering into the business of exporting articles from Canada; or
- (d) has lessened or is likely to lessen competition unduly in relation to an article in the domestic market.

1971: On April 1 the *Shipping Conferences Exemption Act* of 1970 was made effective for up to three years (or until repealed). It was later extended to March 31, 1979. See Bryan and Kotowitz (1978, p. 83).

1976: Effective January 1, the Stage I amendments to the *Combines Investigation Act* become law with the exception of S.32 as applied to the service industries which became effective July 1, 1976. Among the important changes were the following:

- New S.32.2 making bid-rigging illegal per se.
- The maximum fine was set at $1 million for on S.32 where formerly there was no limit.
- New provision (S. 32.3) re conspiracy in professional sports.
- New S.32 (7) exemption of agreements among affiliates.
- New S.32 (6) defence re agreements concerning services.
- New S.32(1.1) re competition need not be virtually eliminated to or the accused had that intent.
- S.32(2) added exemptions (g)(h)(i).
- S.2 was amended to include all services under the Act, i.e., a product was defined to include both articles and services ("industrial, trade, professional or otherwise").
- S.31.1, new provision for private single damage civil actions.

1986: Effective June 19 the following amendments were made to the conspiracy provisions in the new *Competition Act*:

- New S. 32(1.2) provides that the court may infer the existence of a conspiracy "from circumstantial evidence, with or without direct evidence of communication between or among the alleged parties."
- New S. 32(1.3) states that the Crown must prove that the accused intended to and did enter into the agreement, not that the parties to the agreement intended that it have an effect listed in S.32(1), i.e., to lessen competition unduly.
- The maximum fine was increased from $1 million to $10 million.
- S. 32(5)(a) to (d) were repealed, substituting three new exceptions to the basic exemption in S.32(4). First, new S. 32(5)(a) provides that the export exemption does not apply to export agreements that result in a reduction or limitation in the "real value" of exports (previously "volume"). Second, new S.32(5)(b) provides that an export agreement that "has restricted or is likely to restrict any person from entering into or expanding the business of exporting products from Canada" is not exempt from S.32(1). Third, new S.32(5)(c) provides that an export agreement must not lessen competition unduly in the supply of services facilitating the export of products from Canada.
- New S.33 embodies most of previous S.309 of the *Bank Act*. It prohibits agreements among banks concerning interest rates on deposits or loans, service changes, the amount or kind of loans and the kinds of services provided to a customer. Such agreements are a *per se* offence.
- New provisions concerning the exercise of investigatory powers to be consistent with the Charter of Rights and Freedoms in the *Constitution Act* of 1982.
- S.32.01 provides that there will be no double jeopardy re abuse of dominant position or merger.
- Under S.2.1 the commercial activities of Crown corporations were made subject to the Act. See Stanbury (1986).

1988: The Revised Statutes of Canada came into force on December 12. The *Competition Act* is now R.S.C., 1985, c. C-34. The sections are renumbered with S.32 becoming S.45 and S.32.2 becoming S.47 and S.33 becoming S.49.

Chapter 7

CONSPIRACY: FROM WHAT EVIDENCE IS IT APPROPRIATE TO FIND AN AGREEMENT?

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1.0 INTRODUCTION

The conspiracy provisions have played a major role in the evolution of Canadian competition law during the past 100 years. Throughout much of this period, conspiracy formed the backbone of competition law while other provisions languished unused or were proven to be ineffective. Today, other sections of the *Competition Act* (R.S.C. 1985, c. C-34), such as those dealing with merger and abuse of dominant position, have prominence. This is due not only to their recent appearance in a new form but also to the fact that for the first time in Canadian history there is legislation dealing with those subjects which will likely serve its intended purpose. The conspiracy provisions of the *Competition Act* remain in substantially the same form as they have existed for the past century. They continue to be a cornerstone of competition law enforcement in Canada.

The essence of a conspiracy is an agreement. Take away the agreement and you take away the offence. This paper considers some of the evidentiary issues which face the courts in many prosecutions under S.45 (formerly S.32) of the *Competition Act*. There have been a considerable number of conspiracy prosecutions in Canada and many of these cases have reached appellate level courts including the Supreme Court of Canada. Certain aspects of evidence on the subject are well-developed but uncertainty and controversy remain with respect to a variety of issues.

2.0 HISTORICAL REVIEW

The conspiracy offence dates back to the first competition legislation of its kind introduced in Parliament in Canada in 1889. At that time, Parliament passed *An Act for the Prevention and Suppression of Combinations Formed in Restraint of Trade*, S.C. 1889, c.41. This Act prohibited conspiracies, combinations and agreements which had the effect of unduly limiting competition in trade or production.

The 1889 legislation provided:

> "Every person who conspires, combines, agrees or arranges with any other person, or with any railway, steamship, steamboat or transportation company, unlawfully,
>
> (a.) To unduly limit the facilities for transporting, producing, manufacturing, supplying, storing or dealing in any article or commodity which may be a subject of trade or commerce; or
>
> (b.) To restrain or injure trade or commerce in relation to any such article or commodity; or
>
> (c.) To unduly prevent, limit, or lessen the manufacture or production of any such article or commodity, or to unreasonably enhance the price thereof; or
>
> (d.) To unduly prevent or lessen competition in the production, manufacture, purchase, barter, sale, transportation or supply of any such article or commodity, or in the price of insurance upon person or property,
>
> is guilty of a misdemeanour and liable, on conviction, to a penalty not exceeding four thousand dollars and not less than two hundred dollars, or to imprisonment for any term not exceeding two years; and if a corporation, is liable on conviction to a penalty not exceeding ten thousand dollars and not less than one thousand dollars."

The 1889 Act remained the law in Canada until 1892 when it was revised in part and consolidated into S.520 of the *Criminal Code*. In 1899, S.520 was altered by removing "unduly" in subsections (a), (c) and (d) and "unreasonably" in subsection (c). The words "unduly" and "unreasonably" were restored in 1900, but the word "unlawfully" was removed from S.520 at the same time. S.520 was later renumbered as S.498 and subsequently S.411.

In 1960, the conspiracy provisions were moved from the *Criminal Code* to S.32 of the *Combines Investigation Act*, R.S.C. 1952, c.314. In 1976, S.32 was amended by replacing the word "article" with "product", thereby extending the provisions to services. In 1986, the *Combines Investigation Act* was renamed the *Competition Act*. Additional amendments clarified the extent to which competition had to be lessened pursuant to an agreement, if put into effect, in order for an offence to be committed. The amending legislation at that time also dealt with various evidentiary matters and introduced a provision concerning proof of the required intent. A detailed chronology of the conspiracy provisions, 1888-1989, is found at Appendix A of Stanbury, Chapter 6 in this volume.

The current wording of the conspiracy offence in the *Competition Act*, R.S., 1985, c. C-34 is as follows:

> "45(1) Every one who conspires, combines, agrees or arranges with another person

> (a) to limit unduly the facilities for transporting, producing, manufacturing, supplying, storing or dealing in any product,
> (b) to prevent, limit or lessen, unduly, the manufacture or production of a product or to enhance unreasonably the price thereof,
> (c) to prevent or lessen, unduly, competition in the production, manufacture, purchase, barter, sale, storage, rental, transportation or supply of a product, or in the price of insurance on persons or property, or
> (d) to otherwise restrain or injure competition unduly,
>
> is guilty of an indictable offence and liable to imprisonment for a term not exceeding five years or to a fine not exceeding ten million dollars or to both."

It is apparent that the conspiracy provisions have not been altered substantially during their first 100 years of existence.

3.0 ESSENTIALS OF CONSPIRACY

Judicial analysis of the conspiracy provisions of Canadian competition law has succeeded in delineating the fundamental requirements of the offence. These fundamentals serve as a framework for the evidence required to establish the existence of a conspiracy.

Dickson, J., in delivering the majority judgment of the Supreme Court of Canada in *Papalia and Her Majesty the Queen; Her Majesty the Queen and Cotroni*, [1979] 2 S.C.R. 256 at p. 276 stated:

> "The word 'conspire' derives from two Latin words, 'con' and 'spirare', meaning 'to breathe together.' To conspire is to agree. The essence of criminal conspiracy is proof of agreement. On a charge of conspiracy the agreement itself is the gist of the offence: *Paradis v. R.*, (supra) at p.168. The *actus reus* is the fact of agreement: ... The agreement reached by the co-conspirators may contemplate a number of acts or offences. Any number of persons may be privy to it. Additional persons may join the ongoing scheme while others may drop out. So long as there is a continuing overall, dominant plan there may be changes in methods of operation, personnel, or victims, without bringing the conspiracy to an end. The important inquiry is not as to the acts done in pursuance of the agreement, but whether there was, in fact, a common agreement to which the acts are referable and to which all of the alleged offenders were privy. In *R. v. Meyrick and Ribuffi* [(1929), 21 Cr. App.R. 94 (C.C.A.)], at p.102 the question asked was whether 'the acts of the accused were done in pursuance of a criminal purpose held in common between them', and in 11 Halsbury (4th ed.), at p.44 it is said:
>
> > 'It is not enough that two or more persons pursued the same unlawful object at the same time or in the same place; it is necessary to show a meeting of minds, a consensus to effect an unlawful purpose.'
>
> There must be evidence beyond reasonable doubt that the alleged conspirators acted in concert in pursuit of a common goal."

The gist of the conspiracy offence lies in the agreement. It is not necessary that anything further be done in order to complete the offence. Estey, J. noted in *R. v. O'Brien*, [1955] 2 D.L.R. 311 at p. 318:

> "Though dealt with in several sections of the Criminal Code, the result is that conspiracy to commit any indictable offence is itself an indictable offence. Nowhere, however, does the Code define a conspiracy. The definition, therefore, must be found in the common law. Since 1868 the accepted definition has been that of Willes J. in delivering the opinion of the Judges in *Mulcahy v. The Queen*, L.R. 3 H.L. at p.317: 'A conspiracy consists not merely in the intention of two or more, but in the agreement of two or more to do an unlawful act, or to do a lawful act by unlawful means. So long as such a design rests in intention only, it is not indictable. When two agree to carry it into effect, the very plot is an act in itself, and the act of each of the parties, promise against promise, *actus contra actum*, capable of being enforced, if lawful, punishable if for a criminal object or for the use of criminal means.'"

Brett, J.A. in *The Queen v. Aspinall and Others* (1876), 2 Q.B. 48 at p. 58 said:

> "Now, first, the crime of conspiracy is completely committed, if it is committed at all, the moment two or more have agreed that they will do, at once or at some future time, certain things. It is not necessary in order to complete the offence that any one thing should be done beyond the agreement. The conspirators may repent and stop, or may have no opportunity, or may be prevented, or may fail. Nevertheless the crime is complete; it was completed when they agreed."

It need not be proven that the parties actually met or corresponded or that they even knew each other if it can be concluded, beyond reasonable doubt, that their conduct and their actions could only have resulted from a common design: *Regina v. Abitibi Power & Paper Co. Ltd. et al* (1960), 131 C.C.C. 201 (Que.Q.B.) and *Rex v. Eddy Match Co. Ltd. et al* (1951), 104 C.C.C. 39 (Que.K.B.).

Under S.45 of the *Competition Act*, the Crown must prove beyond a reasonable doubt that the parties intended to enter and did enter into a conspiracy, combination, agreement or arrangement to prevent or lessen unduly competition or to enhance unreasonably prices, to limit unduly facilities, manufacturing or production or to otherwise restrain competition unduly: *Container Materials, Limited et al. v. The King*, [1942] S.C.R. 147 at 158.

Batshaw, J. discussed the meaning of "conspiracy" under the *Combines Investigation Act* in *Abitibi* (1960), 131 C.C.C. 201 at p. 209:

> "The two elements of agreement and of common design are thus essential ingredients of the crime of conspiracy. The mere concurrence of intention is not enough. It requires the announcement and acceptance of the intentions. But as soon as the parties come to such an arrangement, the conspiracy is born, even if they never committed any overt act towards carrying it out. The offence is complete as soon as the parties have agreed to the common design."

Lerner, J. adopted these principles in *Regina v. Armco Canada Ltd. and 9 Other Corporations* (1974), 21 C.C.C. (2d) 129 at 176 (Ont.H.C.); affirmed (1976), 30 C.C.C. (2d) 183 (Ont.C.A.).

Motives and desires and even intentions are insufficient to constitute a conspiracy. Suspicions alone cannot avail as proof. There must be evidence of mutual consent to a common design or purpose and there must be an agreement by both parties to carry the design into effect: *The Queen v. Aluminum Co. of Canada Ltd. et al* (1976), 29 C.P.R. (2d) 183 (Que.S.C.).

In *Regina v. Aetna Insurance Co. and 72 Other Corporations* (1975), 22 C.C.C. (2d) 513, Macdonald, J.A. speaking for the majority of the Nova Scotia Court of Appeal (later reversed in the Supreme Court of Canada on other grounds), stated at p. 536:

> "The charge here is one of conspiracy and it is important to remember that the offence is in the conspiracy and not in any overt acts done in consequence thereof. Such overt acts, if any, merely afford evidence of the criminal design of those accused. Kellock, J., in *Howard Smith Paper Mills Ltd. et al. v. The Queen*...,[1957] S.C.R. 403 at p.413, said:
>
> > To adopt in part language used by Meredith, J., as he then was, in *R. v. Elliott* (1905), 9 Can. C.C. 505...: "The crime is in the conspiracy, not in the unlawful acts comprehended in it." A little later on the same page the learned trial Judge pointed out that "By looking at the acts agreed to be done, instead of only at the agreement to do them, the crime is apt to be wrongly multiplied."'
>
> I think that there can be no doubt but that the general law of criminal conspiracy applies to the type of charge in the present case."

The Crown need not prove that the desired purpose of the parties was accomplished. Kellock, J. stated in *Howard Smith Paper Mills Limited et al. v. The Queen*, [1957] S.C.R. 403 at p. 412: "Assuming that during any part of the period of control the aim of the parties to the agreement could not have been successfully carried into execution, such a fact would not, in law, constitute any answer to the indictment."

Although overt acts are not required to prove the conspiracy, conspiracy may be inferred from overt acts which are sometimes looked on as manifestations of the conspiracy. In *Rex v. Miller* (1947), 73 C.C.C. 343 (B.C.C.A.), Sloan, J.A. stated at p.344:

> "On a conspiracy charge the question is not whether there has been participation in acts but in a common design. The acts are links in a chain of collateral circumstance from which the common design may be inferred. They are merely incidental to the object or means of effecting it; the external manifestation of the intent and purpose of each conspirator."

To the same effect are *Rex v. Singer et al*, [1931] 3 D.L.R. 698 (Ont.C.A.) and *Belyea v. The King* (1932), 57 C.C.C. 318 at 336.

In *Container Materials Limited et al. v. The King* [1942] S.C.R. 147, Kerwin, J. said at p. 159:

> "Once an agreement is arrived at, whether anything be done to carry it out or not, the matter must be looked at in each case as a question of fact to be determined by the tribunal of fact upon a common sense view as to the direct object of the arrangement complained of. The evidence in these cases of what was done is merely

> better evidence of that object than would exist where no act in furtherance of the common design had been committed."

Various courts have concluded that the only element of *mens rea* required in cases under S.45 of the *Competition Act* is the intent to enter into the conspiracy, combination, agreement or arrangement in question. The Crown need not establish that the accused intended to prevent or lessen competition or to otherwise have an "undue" effect. It is sufficient if it is established, for example, that the accused intended to enter into an agreement which, if carried into operation, would prevent or lessen competition unduly. Such intention may be determined by the rebuttable presumption that a person intends the natural consequences of his acts: *Her Majesty the Queen v. King*, [1962] S.C.R. 746.

In *Aetna Insurance Company et al. v. The Queen*, [1978] 1 S.C.R. 731 at 748, Ritchie, J. speaking for the majority, described the onus upon the Crown:

> "The burden lying upon the Crown in this case is to establish beyond a reasonable doubt first, that the respondents intended to enter into a conspiracy, combination, agreement or arrangement and, secondly, that that conspiracy, combination, agreement or arrangement if it were carried into effect would prevent or lessen competition unduly. These are questions of fact and the only question of law to which this appeal can be said to give rise is the meaning of unduly in the context of s.32(1)(c)."

To the same effect, Kerwin, J. in *Container Materials* [1942] S.C.R. 147 stated at p. 158:

> "It was argued that it was not sufficient for the Crown to show an agreement or arrangement, the effect of which would be unduly to prevent or lessen competition, but that the agreement or arrangement must have been intended by the accused to have that effect. This is not the meaning of the enactment upon which the count was based. *Mens rea* is undoubtedly necessary, but that requirement was met in these prosecutions when it was shown that the appellants intended to enter, and did enter, into the very arrangement found to exist."

McRuer, C.J.H.C. concluded in *Regina v. Northern Electric Company Limited et al*, [1955] O.R. 431 (Ont.H.C.) at p. 451 that the matter had been "set at rest" by the *Container Materials* judgment.

Houlden, J.A. also said this was the law in *Regina v. Anthes Business Forms Ltd. and 11 Other Corporations* (1974), 19 C.C.C. (2d) 394 (Ont.H.C.); (1976), 26 C.C.C. (2d) 349 (Ont.C.A.); affirmed; [1978] 1 S.C.R. 970, when he said at pp.373-4:

> "If the Court could find on the evidence that the purpose or intention of the parties was to prevent or lessen competition unduly, undoubtedly this would be sufficient for a conviction. But the Crown was not required to prove such a purpose or intention. On the basis of the *Container Materials* judgment, it was only necessary for the Crown to prove that the effect of the agreement, if it was put into operation, would be to prevent or lessen competition unduly."

In *The Queen v. Chatwin Motors Ltd. et al* (1977), 37 C.P.R. (2d) 156 (B.C.S.C.); appeal quashed (1978), 40 C.P.R. (2d) 106 (B.C.C.A.), Ruttan, J. stated at p.159, with respect to the required intention:

> "It is not the intention but the potential effect of the agreement that renders it criminal. This principle has been more elegantly stated in the judgment of Mr. Justice Kerwin in *Container Materials, Ltd. et al. v. The King*...
>
> Thus the effects of the agreement do not have to be intended. Intention is only relevant to the question of agreeing. Whether or not an agreement will have the effect of lessening competition unduly is a question of fact for the Court to decide."

Chatwin Motors reached the Supreme Court of Canada, [1980] 2 S.C.R. 64, where the appeal was dismissed. It was decided at approximately the same time as *Atlantic Sugar Refineries Co. Ltd. et al v. The Attorney General of Canada*, [1980] 2 S.C.R. 644.

Considerable confusion arose as a result of the decision of the Supreme Court of Canada in *Atlantic Sugar*. It is possible to read that case as saying that it is necessary to have the intention to lessen competition unduly. This is contrary to the above-mentioned authorities and one would expect that if the Supreme Court of Canada had any intention of altering its long-established position, it would have done so in a clear fashion.

Doubt as to the extent to which the prosecution must now prove intent was put to rest with the 1986 amendment to the *Competition Act* which states:

> "45(2.2) For greater certainty, in establishing that a conspiracy, combination, agreement or arrangement is in contravention of subsection (1), it is necessary to prove that the parties thereto intended to and did enter into the conspiracy, combination, agreement or arrangement, but it is not necessary to prove that the parties intended that the conspiracy, combination, agreement or arrangement have an effect set out in subsection (1)."

A conviction for conspiracy may occur with any number of participants provided it is established that at least two persons reached the agreement in question. Many activities prohibited under the conspiracy provisions of the *Competition Act* are lawful if carried out unilaterally.

A person may join a conspiracy after it has been in place. The length of participation is a matter which could be considered with respect to sentence. Once an unlawful agreement is established, a single voluntary act in furtherance of the agreement identifies an accused with the conspiracy and renders him liable: *Regina v. Crown Zellerbach Canada Ltd. et al.*, (1955) 5 D.L.R. 27 (B.C.S.C.).

The timeframes of alleged conspiracies under the *Competition Act* are often extended periods. The Crown need not establish that the conspiracy existed throughout the entire period. In *Eddy Match Co. Ltd. et al v. The Queen* (1953), 109 C.C.C. 1 (Que.C.A.), Mr. Justice Casey stated at p.15: "If the control was acquired or was exercised by appellants at any time during the period, then this element of the charge is established." There the accused were charged with the formation of a combine between 1927 and 1950.

Although complete when the agreement is made, conspiracy is a continuing offence and continues so long as the parties to the agreement intend to carry it out: *Director of Public Prosecutions v. Doot and others*, [1973] 1 All E.R. 940 at 949. This concept has been recognized in competition cases: *Howard Smith Paper Mills*, *Abitibi*, and *Eddy Match*.

Whether an accused has conspired, combined, agreed or arranged with another person to prevent or lessen unduly competition is a question of fact to be determined by the evidence before the court in each case: *Regina v. Electrical Contractors Association of Ontario and Dent*, [1961] O.R. 265 (Ont.C.A.).

4.0 MEANING OF AGREEMENT, ARRANGEMENT, ETC.

Section 45 of the *Competition Act* is not limited to "conspires" but also includes "combines, agrees or arranges". In *Rex v. Gage*, [1908] W.L.R. 564 (Man.C.A.), Perdue, J.A. concluded at p. 583:

> "The words 'conspires, combines, agrees, or arranges' are used synonymously in the first part of sec. 498. No doubt, the framer of these sections had in his mind the words commonly used in an indictment charging conspiracy, that the accused 'unlawfully did amongst themselves conspire, combine, confederate, and agree,' etc.
>
> ...
>
> In the statute the word 'arrange' is used in the place of 'confederate,' but this does not affect the point. These 4 words, when found in an indictment, are used collectively or cumulatively to denote the single idea of a conspiracy."

Other judgments distinguish between these various words in the section. Laidlaw, J.A., of the Appellate Division of the Supreme Court of Ontario, stated in *Electrical Contractors* [1961] O.R. 265 at p. 276:

> "The scope of the section is not confined to conspiracy. It extends to and includes the wrong committed by a person who 'combines', 'agrees' or 'arranges' with another person. Two or more persons may wrongfully combine by joining together their acts and activities to accomplish a result or by co-operating one with the other for the desired end. Each of them may take steps to put matters in such order as will lead to a common objective and thus arrange it. Without attempting to define the scope of the class of persons falling within the section it would appear to me sufficient to say that it is not limited to persons who agree one with the other but it includes also persons who combine or arrange to do what is prohibited by the section."

This distinction could be of some significance in dealing with the concept of conscious parallelism. However, the distinction does not appear to have received detailed consideration in that context.

Laidlaw, J.A. continues at p.285:

> "Having found the unlawful intention and purpose of the appellant, I proceed at once to consider whether or not in the circumstances of this case, it conspired, combined, agreed or arranged with another person to carry out its unlawful purpose. I do not direct my attention in particular to the word 'conspires' or to the word 'agrees' used in s.411. I think the word 'combines' and the word 'arranges' used therein are more fitting to the circumstances and the evidence. ... It joined in association and concert with them in such a manner as to be a combination of efforts. It was a person who 'combines' with another person, within the intended meaning of that word in s.411. Again, it took steps in making plans and execution of them in co-operation with members of the association and thus was a person who 'arranges' with another person within the meaning of that section to achieve the prohibited consequence of their joint efforts."

However, Macdonald, J.A. in *Aetna* (1975), 22 C.C.C. (2d) 513 (N.S.C.A.) refers to the above comments of Laidlaw, J.A. in stating at p.543:

> "This suggestion by Laidlaw, J.A., has not been, to my knowledge, repeated in any other case and probably was unnecessary to support his result. In the remainder of his judgment Mr. Justice Laidlaw avoided the words 'conspires' and 'agrees' and found that the accused had 'combined and arranged'. However, from the portion of his judgment earlier quoted it would appear that conspiracy would encompass what Mr. Justice Laidlaw had in mind, and in any event, he appears to have thought that conspiracy was present in the case before him. Mr. Justice Laidlaw did not refer to the decision of the Court of Appeal for Manitoba in *R. v. Gage* (No. 2)...
>
> > 'In the statute the word "arrange" is used in the place of "confederate", but this does not affect the point. These four words, when found in an indictment, are used collectively or cumulatively to denote the single idea of a conspiracy.'"

In the course of reversing the decision of the Nova Scotia Court of Appeal in *Aetna*, the Supreme Court of Canada did not deal with this issue.

In the *Armco* (1974), 21 C.C.C. (2d) 129 case, the trial judge adopted the interpretation of "arrangement" outlined in *British Basic Slag Ltd. v. Registrar of Restrictive Trading Agreements*, [1963] 1 W.L.R. 727. Lerner, J. stated at p. 190:

> "Having found that there was a tacit arrangement or agreement among the members of the Institute to submit identical tenders from price lists which contained uniform prices (on a comparative basis each with the other), it is necessary to define what, in my view, would be an arrangement or agreement which was entered into between the parties that would constitute an ingredient of an offence. In *British Basic Slag Ltd. v. Registrar of Restrictive Trading Agreements*...Willmer, L.J., at p.739 stated:
>
> > 'For when each of two or more parties intentionally arouses in the others an expectation that he will act in a certain way, it seems to me that he incurs at least a moral obligation to do so. An arrangement as so defined is therefore something "whereby the parties to it accept mutual rights and obligations.'"

He also referred at p. 191 to the definition of "arrangement" of Diplock, L.J., which appeared at p. 747:

> "'...it is sufficient to constitute an arrangement between A and B, if (1) A makes a representation as to his future conduct with the expectation and intention that such conduct on his part will operate as an inducement to B to act in a particular way, (2) such representation is communicated to B, who has knowledge that A so expected and intended, and (3) such representation or A's conduct in fulfilment of it operates as an inducement, whether among other inducements or not, to B to act in that particular way.'"

The meaning of "arrangement" expressed by Lerner, J. in *Armco* was expressly overruled on appeal where Houlden, J.A. (1976), 30 C.C.C. (2d) 183 stated at p. 191:

> "Section 32(1)(c) of the *Combines Investigation Act* speaks of 'every one who conspires, combines, agrees or arranges with another person'. Irrespective of the difference in meaning that may or may not exist between 'conspire, combine, agree or arrange' as they are used in the Act, all four words contemplate a mutual arriving at an understanding or agreement between the accused and some other person to do the acts forbidden by paras. (a), (b), (c), or (d) of s.32."

Houlden, J.A. went on to note that the trial judge referred to the definition of "arrangement" in *British Basic Slag Ltd.* and *Electrical Contractors*. In the *Electrical Contractors* case, an incorporated association of electrical contractors "took steps in making plans and execution of them in cooperation with members of the association" for the channelling of all sales of electrical equipment through its members, for the limiting of membership in the association, and for preventing installation of electrical equipment contrary to the policies of the Association. Houlden, J.A. commented at p.192:

> "If parties have acted in the manner described by Laidlaw, J.A., in *Electrical Contractors*, there is undoubtedly an 'arrangement' within the meaning of s.32(1)(c). If, however, the parties have acted in the manner described by the English Court of Appeal in *British Basic Slag*, there is not necessarily an 'arrangement' within the meaning of s.32(1)(c). As has been pointed out, for s.32(1)(c) there must be the mutual arriving at an understanding or agreement, and under the *British Basic Slag* test, this element of mutuality is not necessarily present."

He then refers to the above quotation from *Gage (No. 2)* and concludes:

> "Even if 'arranges' has a different meaning from 'conspires, combines, and agrees' (and I need express no opinion on this point), still as Perdue, J.A., points out, it requires 'the act of agreeing'.
>
> While the trial Judge was wrong, therefore, to refer to the *British Basic Slag* definition, I do not think it invalidates the judgment."

In *Atlantic Sugar*, Pigeon, J., speaking for the majority, embarked on a path which suggested that Section 45 imported contractual doctrines into the law of conspiracy. Pigeon, J. stated [1980] 2 S.C.R. 644 at p.657:

> "When, as expected, the competitors did adopt a similar policy, did this mean that an agreement had been reached? In order to make an agreement by tacit acceptance of an offer there must not only be a course of conduct from which acceptance may be inferred, there must also be communication of this offer. In the case of the list price, this was apparent and did cast a burden on the defence. But there was no such communication of the marketing policy. In those circumstances, did the 'tacit agreement' resulting from the expected adoption of a similar policy by the competitors amount to a conspiracy? I have great difficulty in agreeing that it did...".

Analysis along these lines did not meet with the approval of Estey, J. who, in dissent, concluded at p.673:

> "The argument of the appellant that a tacit agreement cannot support a conviction under s.32(1)(c) carries by implication the notion that s.32 somehow imports the doctrines of the law of contracts into the criminal law. 'Agreement' with nothing more perhaps would connote parties competent at law, the presence of an *animus contrahendi*, consideration flowing between the parties, and the rules of contract law as to form and perhaps even proof. Here, however, we have a section that refers to 'conspires, combines or agrees or arranges'. Each word adds meaning to the sentence. The agreement clearly need not be enforceable for axiomatically it is not. The parties to the transaction must be deemed to know that it is unenforceable as being illegal. They have by their conduct indeed forsaken the ordinary recourse to the civil law. The agreement may be proven, in the sense of being made capable of discernment by the finder of fact from all the surrounding facts and circumstances, including the conduct of the parties."

And continued [1980] 2 S.C.R. 644 at p. 675:

> "It has been said that the section describes a relationship founded on 'the act of agreeing' (*R. v. Gage (No. 2)* (1908), 18 Man. R. 175, per Perdue J.A. at p.220). The 'act of agreeing' is but another way of describing a meeting of the minds of the persons charged. How those minds meet or how the act of agreeing occurs is not limited to the rules and practices of contract law. The four words describe 'agreement' in the broad sense accorded to that word in the language and not the narrow term of art from a specialized branch of the law."

The court decisions dealing with the meaning to be attributed to the initial words in S.45 reflect a tendency to treat the words "conspires", "combines" and "arranges" as being synonymous with "agrees". The broader scope, which could be attributed to these words by giving each a different meaning, has not been adopted. Instead, the traditional test for determining the existence of a conspiracy has generally been utilized in prosecutions under S.45.

5.0 EVIDENCE OF CONSPIRACY

The onus is on the Crown to prove its case by admissible and relevant evidence. The onus never shifts. If, on the whole of the evidence, there is any reasonable doubt that the Crown has proved each of the essential ingredients of the offence, then the accused must be given the benefit of that doubt and acquitted.

5.01 Tacit and Inferred Agreements

A conspiracy may be established by proof that the accused actually met together and entered into an alleged agreement or it may be inferred by proof of a course of conduct. Competition cases in Canada are replete with statements to the effect that it is seldom tha conspirators set down the object of the conspiracy in writing and that it is seldom possible to establish the common design necessary for proof of a conspiracy by direct evidence. Instead, it is said that the usual method of proof of a conspiracy is indirectly from inferences drawn from actions or conduct of the parties.

Rinfret, J. said in *Paradis v. His Majesty The King* [1934] S.C.R. 165 at 168:

> "Conspiracy, like all other crimes, may be established by inference from the conduct of the parties. No doubt the agreement between them is the gist of the offence, but only in very rare cases will it be possible to prove it by direct evidence. Ordinarily the evidence must proceed by steps. The actual agreement must be gathered from 'several isolated doings',... having possibly little or no value taken by themselves, but the bearing of which one upon the other must be interpreted; and their cumulative effect, properly estimated in the light of all surrounding circumstances, may raise a presumption of concerted purpose entitling the jury to find the existence of the unlawful agreement."

In *Regina v. Canadian General Electric Company Ltd. et al.* (1976), 34 C.C.C. (2d) 489 (Ont.H.C.), the large lamp industry was described as characterized by price cutting previous to the introduction of an open-price policy. In commenting on the activities of the sales manager, the judge said at p. 518 that his conduct was not that of a competitor but one "who believed that the accused were united in an agreement, express or implied, to act together and pursue a common purpose."

In *Armco* (1974) 21 C.C.C. (2d) 129, Lerner, J. stated at p. 146:

> "(As appears from the reported judgments, it is unnecessary to establish persuasion by inducement or compulsion. The establishment of a voluntary, uncoerced, tacit agreement is sufficient to prove the offence: *R. v. Northern Electric Co. Ltd. et al...*; *R. v. Abitibi Power & Paper Co. Ltd. et al...*; *R. v. Electrical Contractors Ass'n of Ontario and Dent...*".

Acts, which by themselves are legal and appear to be quite innocent, may begin to form a sinister pattern or have a sinister tendency when viewed with other evidence. The inferences deduced therefrom may satisfy the trial judge beyond a reasonable doubt that in fact an agreement or arrangement has been concluded between any two of the accused or between any one of the accused and an unindicted co-conspirator: *The King v. Brisac and Scott* (1803), 102 E.R. 792.

The following statement by Mr. Justice Bienvenue in *R. v. Eddy Match Company Limited et al.* (1952) 17 C.P.R. 17 (Que.K.B.) at p. 44 has been approved frequently:

> "There is no cause for surprise that one does not find in the minute books the text of the agreements or arrangements which could have been made by defendants. In the case of such offences, one seldom finds, if ever, concrete, clear-cut evidence of agreements the purpose of which is to create a monopoly or to operate it.
>
> It cannot be expected, especially, that such evidence will be found in the minute books of a company. Neither can one be expected to be in a position to establish that the officers of commercial corporations met and agreed in an explicit manner to organize a combine, a trust or a monopoly with a view to brush aside all competition.
>
> It is sufficient, as for any other criminal matter, to be in a position to draw from the whole of the evidence that an agreement, even tacit, was in fact concluded, that a common plan was conceived and set in operation to violate the Act, regardless of the results obtained."

To similar effect are the comments of Batshaw, J. in *Abitibi* (1961) 131 C.C.C. 201, at p. 238:

> "The situation in the case at bar, moreover, parallels closely that described in the discussion on the law of conspiracy in Kenny's Outlines of Criminal Law, 17th ed., p.395 and following, where the author states:
>
> > 'It rarely happens that the actual fact of the conspiring can be proved by direct evidence since such agreements are usually entered into both swiftly and secretly. Hence they ordinarily can be proved only by an inference from the subsequent conduct of the parties, in committing some overt acts which tend so obviously towards the alleged unlawful result as to suggest that they must have arisen from an agreement to bring it about. Upon each of several isolated doings a conjectural interpretation is put; and from the aggregate of these interpretations an inference is drawn. The circumstantial evidence thus rendered necessary will often embrace a very wide range of acts, committed at widely different times and in widely different places....in cases of conspiracy an unusually long interval often elapses--with consequently an unusually long series of acts--between the time when the common criminal purpose is formed and the time when it is carried out or is frustrated by arrest'".

In *Rex v. Alexander Ltd. et al*, [1932] 2 D.L.R. 109 (Ont.S.C.), it was stated that although combines take many forms, one of the most pernicious is the 'gentlemen's agreement' by which all persons in the combine agree to fix a standard price by which all must abide.

It was argued in *Atlantic Sugar* that an earlier modification of the statute established that the legislative intention was to exclude tacit agreements from Section 45. The first *Combines Investigation Act*, 1910 (Can.), c.9, s.2(c) made no distinction between a tacit agreement and an explicit agreement. However, the Act was modified in 1919, (Can.), c.45, s.2(c), to read as follows: "The expression 'combine'... shall be deemed to include... (c) any actual or tacit contract, agreement, arrangement or combination..." The Act was further amended in 1923, 1935 and 1952, and continued to utilize the word "tacit." In 1960, the text was changed and that reference was dropped. The argument in *Atlantic Sugar* that the legislative intention was to no longer prohibit tacit agreements was rejected.

However, the Supreme Court of Canada in *Atlantic Sugar* [1980] 2 S.C.R. 644 went on to create some confusion about whether an agreement could be inferred from circumstantial evidence. This confusion was put to rest by the enactment in 1986 of Section 45(2.1) which states:

> "In a prosecution under subsection (1), the court may infer the existence of a conspiracy, combination, agreement or arrangement from circumstantial evidence, with or without direct evidence of communication between or among the alleged parties thereto, but, for greater certainty, the conspiracy, combination, agreement or arrangement must be proved beyond a reasonable doubt."

The cumulative effect of the evidence must bring the court to its conclusion. This was emphasized by Boyd McBride, J. in *Rex v. McGavin Bakeries Limited et al* (No. 6) (1951), 3 W.W.R. (N.S.) 289 (Alta.S.C.) at 316:

> "At this point I feel it necessary to emphasize that my finding of guilty is not based upon any one or more of those facts or episodes I have discussed, nor of those I have refrained from discussing, many of which latter standing alone might perhaps be considered innocent. I have based my finding against the accused on a consideration of the whole evidence, on my interpretation of the bearing of the isolated doings one on the other and on the cumulative effect, together with my 'common sense' view of the direct object of the agreement complained of."

Lerner, J. in *Armco* (1974), 21 C.C.C. (2d) 129 went on to say that the cumulative effect of all the evidence with uniformity of prices for 3 years and 9 months had convinced him that there was a tacit agreement to maintain identical prices.

It is not necessary for the Crown to prove motive. However, the presence or absence of motive would be taken into consideration in weighing circumstantial evidence: *Regina v. St. Lawrence Corp. Ltd. et al* (1966), 51 C.P.R. 170 (Ont.H.C.).

5.02 The Rule in Hodge's Case

The rule in *Hodge's Case* has been applied in several Canadian competition prosecutions. In recent years, the scope of the rule has been questioned and narrowed. It has been applicable when proof of a conspiracy and of an accused's participation in it rests on the inferences to be drawn from circumstantial evidence. The rule comes from *Hodge's Case* (1838), 168 E.R. 1136. As part of the jury instruction, Baron Alderson told the jury:

> "...the case was made up of circumstances entirely; and that, before they could find the prisoner guilty, they must be satisfied, 'not only that those circumstances were consistent with his having committed the act, but they must also be satisfied that the facts were such as to be inconsistent with any other rational conclusion other than that the prisoner was the guilty person.'"

In applying the rule in *Northern Electric* [1955] O.R. 431, McRuer, C.J.H.C. said at p. 434:

> "It has also been pointed out that this is a case that depends upon circumstantial evidence and the proper inferences to be drawn from the evidence. I am likewise conscious of the law applicable to circumstantial evidence and that the circumstances must convince the tribunal of fact beyond a reasonable doubt that they are consistent with the guilt of the accused and that they are beyond a reasonable doubt inconsistent with any other rational conclusion."

The rule has been applied in many other cases including *Regina v. Burrows et al* (1966), 54 C.P.R. 95 (B.C.S.C.), *Abitibi*, and *Armco* at p.176 and on appeal at p.194.

Boyd McBride, J. in *McGavin Bakeries Limited et al. (No. 6)* (1951), 3 W.W.R. (NS) 289, applied this test to each of the accused corporations, in turn, not only to the evidence as a whole, but also separately to the very numerous individual facts and circumstances said to be indicative of conspiracy. Other cases have concluded that it is not each item of circumstantial evidence which must meet the test in *Hodge's Case*. It has been found that it is sufficient if all of the facts put in evidence, when considered together, satisfy the rule: *John v. Her Majesty the Queen*, [1971] S.C.R. 781 and *Armco* (Ont.C.A.).

In *Regina v. Cooper*, [1978] 1 S.C.R. 860, the Supreme Court of Canada considered what was said by that Court in *Regina v. Mitchell*, [1964] S.C.R. 471. In *Mitchell*, Spence, J. asked whether the fact that evidence is circumstantial necessarily requires an instruction be given to the jury in accordance with that which was given in *Hodge's Case*. Ritchie, J., in *Cooper*, indicated that *Hodge's Case* was concerned only with the identification of the accused and it had no application to a case turning upon the intention of the accused. At p. 881, he dealt with the applicability of the rule in Canada:

> "This is not to say that, even where the issue is one of identification, the exact words used by Baron Alderson must necessarily be incorporated in a judge's charge. It is enough if it is made plain to the members of the jury that before basing a verdict of guilty on circumstantial evidence they must be satisfied beyond a reasonable doubt that the guilt of the accused is the only reasonable inference to be drawn from the proven facts. In this regard it will be seen that I agree with the Chief Justice in his rejection of the *Hodge* formula as an inexorable rule of law in Canada."

Laskin, C.J., with Judson and Dickson, J.J. concurring, dissented in *Cooper*. They were of the view that the charge taken as a whole confused the jury as to the degree of proof required. Laskin, C.J. stated at p.865:

> "The time has come to reject the formula in *Hodge's* case as an inexorable rule of law in Canada. Without being dogmatic against any use of the formula of the charge in *Hodge's* case, I would leave the matter to the good sense of the trial judge (as was said in *McGreevy*), with the reminder that a charge in terms of the traditional formula of required proof beyond a reasonable doubt is the safest as well as the simplest way to bring a lay jury to the appreciation of the burden of proof resting on the Crown in a criminal case."

Mitchell determined that generally the rule in *Hodge's Case* is not applicable to proof of intent. In many conspiracy cases the intent and the agreement itself are almost inextricably intertwined so that it is difficult to conceive that the accused would have become a party to the agreement unless he intended to do so. In such cases, the issue is really membership in the agreement. Where the issue is whether or not an accused was a party to an agreement and the evidence is circumstantial, the rule in *Hodge's Case* has been applied: *Regina v. McDonald et al*, [1973] 1 W.W.R. 481 (Alta.C.A.), *Regina v. Smith*, [1972] 2 O.R. 219 (Ont.C.A.), and *Aluminium* (1976), 29 C.P.R. (2d) 183 (Que.S.C.).

In *The Queen v. Atlantic Sugar Refineries Co. Ltd. et al* (1975), 26 C.P.R. (2d) 14 (Que.S.C.); (1978), 41 C.C.C. (2d) 209 (Que.C.A.), Mackay, J. at trial said at p.23 that proof of intent, like proof of an agreement, is seldom susceptible of being made by direct evidence and is generally established by inference drawn from the evidence and having a cumulative effect. This being so he said that the rule in *Hodge's Case* was applicable. In the Supreme Court of Canada, Pigeon, J. for the majority, said at (1981) 115 D.L.R. (3d) 21 at p. 32 that in view of the decision of the Supreme Court of Canada in *Cooper*, Mackay, J. was in error.

In *R. v. Cominco Ltd.*, [1980] 2 W.W.R. 693 (Alta.S.C.), the Crown argued that in view of the decisions of *Cooper* and *Mitchell*, the rule in *Hodge's Case* with regard to circumstantial evidence did not apply to conspiracy cases. Instead, it was asserted that the proper test was the standard onus placed on the Crown that the Crown must prove beyond a reasonable doubt the guilt of the accused. Brennan, J. commented at p.707 that the *Cooper* case did not overrule various of the cases which had applied the rule in *Hodge's Case*. He recognized that the question of whether the opinions delivered in the cases referred to continued to correctly state the law of Canada has most certainly been put in issue by the Supreme Court of Canada in *Cooper*. Spence, J. in *Cooper* indicated that the exact words used by Alderson, B. in *Hodge's Case* need not be incorporated in a judge's charge. Brennan, J. concluded in *Cominco* at p.708:

> "It is my view that I would be paying due respect to the opinions expressed in the *Cooper* case if I were to approach the evidence before me with a view to determining whether such evidence satisfied me beyond a reasonable doubt that the accused are guilty as charged.
>
> Whether I am so satisfied will, of course, depend on the interpretation I am prepared to place upon all of the evidence. If I am satisfied beyond a reasonable doubt that the only--and I stress the word 'only'--reasonable interpretation which can be drawn from the proven facts establishes the guilt of the accused, then in such case I would be satisfied beyond a reasonable doubt as to guilt and this would be my finding. It necessarily follows that if the facts proved also lend themselves to a reasonable inference being drawn which is inconsistent with guilt, this would give rise to a reasonable doubt as to guilt and would result in an acquittal."

The Crown did not appeal the acquittal of the accused.

5.03 Acts and Declarations of Co-conspirators

In conspiracy cases there is an important exception to the general rule relating to hearsay evidence. Acts and declarations of one conspirator carried out in furtherance of the common design may be given in evidence against all of the other co-conspirators. This rule is based upon a principle of agency. If two people have agreed to achieve a common unlawful purpose, then by their agreement each is said to have made the other his agent to achieve the purpose. The result is that the acts and declarations of one in furtherance of the common design are not only the first person's acts and declarations but in law are also those of the second person.

This exception only comes into play where there is evidence fit to be considered by the jury that the conspiracy alleged between the two persons exists. Where a fact in issue is whether a conspiracy exists between the two persons, one's acts or declarations implicating the other cannot be used to prove that the other was a party to the conspiracy, in the absence of some other evidence admissible against that person to bring him within the conspiracy: *Regina v. Baron and Wertman* (1976), 14 O.R. (2d) 173 (Ont.C.A.).

In practice, the application of this rule can create difficulties, particularly in complex conspiracy cases. Proving the existence of an agreement may involve the introduction into evidence of testimony of numerous witnesses and many hundreds or possibly thousands of documents. In the absence of a direction by the trial judge with respect to the way in which an agreement may be proven, delays could result and trials could be prolonged. The order of proof is within the discretion of the trial judge. Evidence of the separate acts and declarations of alleged conspirators may be given in evidence before the agreement is established: *Paradis* [1934] S.C.R. 165. In effect, the trial judge will admit the evidence of acts and declarations of the conspirators and if a conspiracy is established, such acts and declarations become the acts and declarations against co-conspirators. The separate acts of alleged conspirators may initially and provisionally be admitted and viewed in combination in order to establish the conspiracy. If, at the end of the case, there is not sufficient evidence admissible against an alleged conspirator that he was a party to the conspiracy, that conspirator must be acquitted.

The degree of proof of the conspiracy and of the accused's connection with it, which is required to make the acts and declarations of an alleged co-conspirator evidence against him, differs, however, from that required to establish his guilt on the charge. *Prima facie* proof of an accused's connection with the conspiracy by evidence admissible against him makes the acts and declarations of co-conspirators admissible against him: *Rex v. Container Materials Ltd. et al*, [1940] 4 D.L.R. 293 (Ont.S.C.); affirmed [1941] 3 D.L.R. 145 (Ont.C.A.) and [1942] 1 S.C.R. 147.

What is the practical effect of this provisional acceptance of the evidence? The procedure may have the appearance of being unjust in that in permitting such declarations to be admitted before a conspiracy has been established, there is the concern that such evidence could be used to establish a conspiracy. In very complex cases it may be difficult for the judge to separate the evidence which must be used to establish the conspiracy from the remainder of the evidence. Also, the judge will have formed an impression of the case based on the whole of the evidence before this two-step application of the evidence occurs.

In *Rose v. The King*, [1947] 3 D.L.R. 618 (Que.C.A.), Barclay, J. said at p.628:

> "In a conspiracy case the evidence changes its character as the case proceeds. Evidence given by a co-conspirator may at first be only evidence against the witness himself, not the accused, but as and when a conspiracy is proved in which the accused was involved, then such evidence, if it be of acts in furtherance of a common design, becomes evidence against the accused. Where the evidence lays a sufficient foundation to show that several persons have met for the purpose of conspiracy, the declaration of any of the parties, or of any person shown to be connected with that conspiracy, made at any time or place, relative to the object of the conspiracy, is evidence against each and all."

In the same case, Bissonnette, J. said at p. 652:

> "The ideal system most certain and least prejudicial to the accused, and consequently the least open to attacks in law against a verdict, is to first prove the conspiracy, the participation of the accused in such offence, and then, to submit all the secondary evidence which could bind the conspirators together, establish the realization of their plan, the illegal means used, etc. But this rule is not de rigueur. Many cases say that conspiracy is established incident by incident, brick by brick, up to the moment when, seeing all the agents of the offence as upon a chess board, the decisive proof that there has been an illegal agreement is adduced."

The rationale for proceeding with the trial in this fashion is said to be that proof of a conspiracy is frequently established from a number of acts carried out by co-conspirators often separated from one another and sometimes even without an apparent link between them. Such acts, when considered separately, may have no importance but when connected with other acts, may establish requisite proof of a conspiracy. Therefore, there is a tendency to provisionally introduce all of the evidence.

In *Container Materials* [1940] 4 D.L.R. 293 (Ont.S.C.), Hope, J. concluded at p. 307:

> "Acts and declarations of one of a company of conspirators or documents in his possession are receivable in evidence against him and in the event of common design being proven to the satisfaction of the Court, they become evidence against his fellow-conspirators. A foundation should first be laid by proof sufficient in the opinion of the Judge to establish *prima facie* the fact of the conspiracy between the parties, or at least proper to be laid before the jury as tending to establish such fact. ...Oft-times for the sake of convenience, the acts or declarations of one are admitted in evidence before sufficient proof is given of the conspiracy, the prosecutor undertaking to furnish such proof in a subsequent stage of the case. The mode of proceeding rests in the discretion of the trial Judge."

Hope, J. went on to say that a conspiracy need not be established by direct proof, which actually brings the parties together, but may be shown, like other facts, by circumstantial evidence. The detached acts of different people, including their written correspondence and entries made by them on other documents in their possession, sometimes from necessity, will be admitted as steps to establish the conspiracy itself. The seriousness of this procedure comes to the forefront with the recognition that such acts and declarations may have come from conspirators not charged, or alternatively, were made in the absence of the party against whom they were offered and without his knowledge.

Regina v. Murphy and Douglas (1837), 173 E.R. 502 established that one must distinguish between acts done or declarations made in pursuance of a common design from acts which are mere narrative or statements made with reference to the common design but not in furtherance of it. Such declarations are evidence against the accused making the statement to show his participation in the conspiracy but are not evidence against the co-conspirators. On the other hand, acts done or declarations made in furtherance of the common design are evidence against all implicated in the conspiracy: *Northern Electric* [1955] O.R. 431 at p. 449.

It is not always easy to separate mere narrative from declarations made in pursuance of a common design. In *Armco*, objection was taken to the admission of the statement in a memorandum "They surely are not playing ball". The memorandum was made by one accused informing another accused that a third accused had underbid the first on a particular contract. It was argued that this statement was mere narrative or an expression of an opinion. This argument was rejected at trial and by the Ontario Court of Appeal.

5.04 Section 69

Section 69 (formerly S.45) of the *Competition Act* made a major change in the law of evidence in competition prosecutions. It provides:

> "69(1) In this section,
>
> 'agent of a participant' means a person who by a record admitted in evidence under this section appears to be or is otherwise proven to be an officer, agent, servant, employee or representative of a participant;
>
> 'document' [Repealed, 1986, c.26, s.42]
>
> 'participant' means any person against whom proceedings have been instituted under this Act and in the case of a prosecution means any accused and any person who, although not accused, is alleged in the charge or indictment to have been a co-conspirator or other party or privy to the offence charged.
>
> (2) In any proceedings before the Tribunal or in any prosecution or proceedings before a court under or pursuant to this Act,
>
> (a) anything done, said or agreed on by an agent of a participant shall, in the absence of evidence to the contrary, be deemed to have been done, said or agreed on, as the case may be, with the authority of that participant;
>
> (b) a record written or received by an agent of a participant shall, in the absence of evidence to the contrary, be deemed to have been written or received, as the case may be, with the authority of that participant; and
>
> (c) a record proved to have been in the possession of a participant or on premises used or occupied by a participant or in the possession of an agent of a participant shall be admitted in evidence without further proof thereof and is *prima facie* proof
>
> (i) that the participant had knowledge of the record and its contents,
>
> (ii) that anything recorded in or by the record as having been done, said or agreed on by any participant or by an agent of a participant was done, said or agreed on as recorded and, where anything is recorded in or by the record as having been done, said or agreed on by an agent of a participant, that it was done, said or agreed on with the authority of that participant, and
>
> (iii) that the record, where it appears to have been written by any participant or by an agent of a participant, was so written and, where it appears to have been written by an agent of a participant, that it was written with the authority of that participant."

This extraordinary provision was initially enacted shortly after *Rex v. The Ash-Temple Company Limited et al*, [1949] O.R. 315 (Ont.C.A.). Today the Section is substantially in its original form. In 1970, the current wording in subparagraph 69(2)(c) "*prima facie* proof" replaced the phrase "*prima facie* evidence". Other minor revisions have been made from time to time.

In the *Ash-Temple* case, the Court refused to admit many documents into evidence because they were not properly proven. There was no proof that certain people who wrote letters had authority to act for the company and in other instances there was no proof of signatures on original letters.

The Crown did not establish that the Board of Directors had involvement in carrying out the arrangements alleged.

Competition authorities succeeded in convincing the legislators of the day that this decision put an insurmountable roadblock in the way of prosecutions for competition offences. To ease the burden on the Crown, this section was enacted in 1949. The impact of the section had been well-recognized by the courts. Cartwright, J. commented in *Howard Smith Paper Mills* at p. 420: "...s.41 [now s.69] makes a revolutionary change in the law of evidence...".

The effect of these provisions is to vacate considerably the common law rules which would normally apply to the admissibility and probative value of records: *Aluminum* (1976), 29 C.P.R. (2d) 183. Boyd McBride, J. stated in *Rex v. McGavin Bakeries et al (No. 5)* (1951), 100 C.C.C. 215 (Alta.S.C.) at 223:

> "The intent and effect of s.39A [now s.69] is to introduce the important changes in the law of evidence which I have been discussing, where the accused, whether an individual or corporation, is on trial on a charge of criminal conspiracy ... by requiring less specific proof of certain matters than otherwise the Crown would be required to adduce, before documents, or things, said, done, or agreed upon by an agent, become admissible."

The fact that in these cases judges frequently base their decision on the bearing of isolated incidents one on the other and on the cumulative effect of the evidence makes the section a potent weapon in the Crown arsenal.

The definition of "document" in the section was repealed in 1986 and the reference to "document" in the Section was replaced with "record". Section 2 of the *Competition Act* now contains the following definition of "record":

> "'record'includes any correspondence, memorandum, book, plan, map, drawing, diagram, pictorial or graphic work, photograph, film, microform, sound recording, videotape, machine readable record, and any other documentary material, regardless of physical form or characteristics, and any copy or portion thereof;".

Section 69(2)(c) requires proof of possession of a record. This means bare possession or bare custody. Proof that the participant has knowledge of the record's existence is not necessary: *McGavin Bakeries (No. 5)* at pp. 223-224.

Section 69(2) is not limited to documentary evidence. The Section applies to indicted as well as unindicted co-conspirators. Proponents of a broad interpretation of the Section assert that although the common law rules dealing with conspiracy exclude narrative statements not in furtherance of the common design, mere narrative statements admitted under this Section are evidence against other participants: *Atlantic Sugar* (1975) 26 C.P.R. (2d) 14 (Que.S.C.) at p. 37. In addition, at common law, while acts and declarations of alleged conspirators are often admitted conditionally, subject to eventual proof of an agreement, under S.69 evidence is admitted unconditionally.

Section 69 defines "participant" to mean any person against whom proceedings have been instituted under the Act and in the case of a prosecution, means any accused and any prson who, although not an accused, is alleged in the charge or indictment to have been a co-conspirator or otherwise party or privy to the offence charged. Under Section 69, records are admitted in evidence against all participants, not only the participant in whose possession the record was found: *McGavin Bakeries (No. 5)* at p. 225 (Alta.S.C.), *Aluminum* at p. 188 (Ont.H.C.), and *Howard Smith Paper Mills* at p. 418 (S.C.C.).

A record from one participant to another implicating a third participant is admissible under Section 69 to prove the involvement of the third participant in the conspiracy: *Armco* at p. 190 (Ont.C.A.).

A relevant record found in the possession of a participant is admissible even though the record was created when that participant was not alleged to have been a member of the conspiracy: *Anthes* at p. 366 (Ont.C.A.).

For the purposes of Section 69, a person may be proven to be an "agent of a participant" either by a record admitted in evidence under this section or otherwise. Where a person is proved to be an "agent of a participant" through a record entered in evidence under Section 69, his acts proved other than by records tendered under Section 69 nevertheless bind the participant in accordance with subsections 69(2)(a) and (b): *Regina v. Phillips Electronics Industries Ltd. et al.* (1966), 52 C.P.R. 224 at 239 (Ont.H.C.).

The definition of "participant" in Section 69 is sufficiently broad to create the prospect of abuse in the formulation of an Information. The mere naming of a person as an unindicted co-conspirator makes that person a "participant" and enables documents seized from that person to be introduced in evidence against the accused. The person need not be otherwise proven to be a co-conspirator. Consequently, forward planning on the part of a prosecutor could result in the naming of parties as unindicted co-conspirators solely for the purpose of enabling Section 69 to be used in introducing records as evidence. An accused may be faced with having to rebut evidence introduced through the records of a non-party who would often not be called as a witness by the Crown and whose cooperation with an accused in providing defence evidence may not be forthcoming.

A record which is found on the premises of one participant and which records something as having been agreed upon by another participant is *prima facie* proof against both, although the statement may appear in a document, such as an interoffice memorandum, which never left the premises of the participant in whose possession it was found: *Howard Smith Paper Mills*.

The definition of "record" leaves open the question of whether the Crown can introduce a single page from a group of attached or related pages. For example, if a diary seized from the possession of a participant contains numerous entries, some of which are helpful and some harmful to the Crown's case, is the Crown required to introduce into evidence the entire diary? The trial judge in *Cominco* ruled that the Crown was at liberty to introduce single pages in view of the common law definition of "document." Boyd McBride, J. in *McGavin Bakeries (No. 5)* held that the term "document" should not be interpreted by courts in such a way as to place it in a straitjacket.

It would appear that there is no need for memos, notes or minutes of meetings to be signed in order to be introduced under S.69: *McGavin Bakeries (No. 5)* and *Crown Zellerbach*.

5.05 Prima Facie Proof

Section 69 provides that records coming within the Section constitute *prima facie* proof. Prosecutors have asserted that the wording of the Section suggests that anything recorded in a record admitted under S.69 as having been done, said or agreed upon by a participant or an agent of a participant, is to be accepted as having been done, said or agreed upon by the participant or by the agent of the participant with the authority of the participant unless there is credible evidence to the contrary. If there is evidence to the contrary, it is then a question for the trial judge to weigh all of the evidence in coming to his conclusion of guilt or innocence.

Section 69 does not make *prima facie* proof of any offence. It makes *prima facie* proof of facts recorded in certain records. If a judge accepts as proved all facts recorded in the records, he must determine whether those proven facts establish beyond a reasonable doubt that the accused is guilty of the offence charged.

In *Howard Smith Paper Mills* (1957) S.C.R. 403, Cartwright, J. said at p. 420:

> "I am in substantial agreement with the reasons of Casey J. [in *Eddy Match Co. Ltd. et al v. The Queen* (1953), 20 C.P.R. 107, 109 C.C.C. 1, 18 C.R. 357] on this point. While s.41 [now s.69] makes a revolutionary change in the law of evidence, it creates no offence, it takes away no defence, it does not render criminal any course of conduct which was not already so declared before its enactment, it does not alter the character or legal effect of any transaction already entered into; it deals with a matter of evidence only ...".

In the Supreme Court of Canada, Ritchie, J. writing for the majority, held in *Sunbeam Corporation (Canada) Limited v. Her Majesty the Queen*, [1969] S.C.R. 221 at 229 that:

> "Section 41(2)(c) [now s.69(2)(c)] simply provides that documents, such as these letters, which were in the possession of the accused 'shall be admitted in evidence without further proof thereof and shall be *prima facie* evidence' that the accused had knowledge of the documents and their contents and that anything recorded in them as having been done, said or agreed upon by the accused or its agent, was done, said or agreed upon. This does not mean that the trial judge, having accepted the letters as *prima facie* evidence of their contents, is precluded from assessing the weight to be attached to that evidence in considering the issue of the accused's guilt or innocence."

Ritchie, J., as well as Spence, J. in dissent, discussed at some length the meaning of "*prima facie* evidence". At that time, the Section had not yet been amended to change "*prima facie* evidence" to "*prima facie* proof". See also *Atlantic Sugar* (Que.S.C.) and *Aluminum* (1976), 29 C.P.R. (2d) 183 (Que.S.C.).

In *Anthes* (1975), 26 C.C.C. (2d) 349, Houlden, J.A. summarized the effect of the Section at pp. 383 and 384:

> "Parliament, in enacting what is now s.45 clearly intended to create a presumption of fact that documents written or received by an agent of a 'participant' were written or received with the authority of that participant; that those persons appearing from the documents or otherwise shown to be officers, agents, servants, employees or representatives of a participant acted with authority; and that anything recorded in a document as having been done, said or agreed upon by a participant or an agent of a participant was in fact done, said or agreed upon as recorded, and where done, said or agreed upon by an agent, then it was done, said or agreed upon with the authority of the participant. In short, the common law principles and rules of evidence in *Ash-Temple, supra*, were abrogated by Parliament."

In *Canadian General Electric* (1974), 17 C.C.C. (2d) 433 at p. 493, Pennell, J. comments:

> "It [s.69] does not deprive the accused of the right of rebutting the *prima facie* proof of the matters specified in the section. It does not create an offence. It simply states the manner in which the Crown may map its course:...".

The court is not bound by the literal words used in a document introduced into evidence pursuant to S.69. In *St. Lawrence* (1966), 51 C.P.R. 170 at p. 185, Shatz, J. concluded that a statement in a document that something was "felt" by an accused may be interpreted to mean that a person had spoken this to the accused and that the accused had done something to lead the writer to the conclusion recorded. Similarly, common sense inferences can be made from statements appearing in a document such as "they surely are not playing ball": *Armco Canada* (Que.S.C.) (1974), 21 C.C.C. (2d) 129 at p. 190 and *Howard Smith Paper Mills* [1957] S.C.R. 403 at p. 417.

A procedure commonly followed in prosecutions under the *Competition Act* is that the Crown calls as witnesses the officers who seized the records to establish that they were seized from the premises of participants. Upon this evidence being tendered, the Crown then asserts that any record which falls within the terms of S.69 must be admitted in evidence when tendered by the Crown without further proof. If accepted, the records are then simply filed as exhibits and become part of the Crown's case.

There appears to be no obligation on the prosecutor to call as witnesses the authors of records which come within the provisions of Section 69 even though such authors are available. In *Regina v. Encyclopaedia Britannica Publications Ltd.* (1975), 28 C.P.R. (2d) 201 at 207 (Ont.Prov.Ct.) it is stated:

> "Under s.45(2)(c) [now s.69(2)(c)], documents introduced pursuant to s.45 are, therefore, subject to rebuttal by the defendant, *prima facie* proof of the matter set out in the section. It is not incumbent on the Crown to produce further proof by producing the authors of such documents and presenting these persons for cross-examination by the defendant. It is open to the defendant to rebut the *prima facie* proof of the matter specified in s.45 in whatever fashion it deems most effective."

Grant, J. in *Anthes* (Ont.H.C.) reached the same conclusion.

The argument is that if the Crown was under such an obligation, it would face the difficulty of having to call hostile witnesses without having an opportunity to learn in advance of their testimony. The fact that the proof is *prima facie* only is used to support this argument in the sense that the accused may call the authors in an attempt to refute the evidence. This, of course, assumes that such authors are available. Should the authors not be available, an accused could be placed in the prejudicial position of having *prima facie* proof of certain facts established without having the opportunity to test the foundation for such statements or the credibility of the maker of the statements through cross-examination.

The potential prejudice is significant. A review of conspiracy prosecutions under the *Competition Act* and its predecessors shows that frequently the charges cover a lengthy period of time. Ten to fifteen years is not unusual. Also, there can be substantial delay in laying the charges. In the Western Trucking case, *Canadian National Transportation Limited et al v. Provincial Court of Alberta* (1984), 55 A.R. 229 (Alta.Q.B.); (1985), 39 Alta.L.R. (2d) 299 (Alta.C.A.); [1986] 2 S.C.R. 711, the investigation began in 1968. The charge was laid in 1979. The charge related to the period 1960 to 1979. When the case was resolved by way of a prohibition order in 1986, the case had not yet reached the Preliminary Inquiry stage. Potential witnesses had died. An application to quash the charge based on the 1982 Canadian *Charter of Rights and Freedoms* was made on the ground of inordinate delay in laying the charge. That issue proceeded to the Supreme Court of Canada where relief was denied. Had the case proceeded to trial, the accused would have been faced with records admitted under S.69 going back to a period 25 years earlier. Rebutting *prima facie* proof of events over such a prolonged period of time would be extremely difficult, if not impossible. Section 69 has the practical effect of requiring the accused to produce witnesses to rebut the evidnece in records introduced through this provision.

A further illustration of the difficulty which an accused could face if defence witnesses are not available and records are introduced pursuant to S.69 is revealed in a memo introduced by the Crown in the *Aluminum* case (1976) 29 C.P.R. (2d) 183 referred to at p. 197. An internal memo sent by an Alcan manager to an Alcan vice-president stated:

> "I have talked to everybody on basis of 1.2 cents/pound extrusion ingot price increase across the board and carried over into extrusion prices. All have agreed to implement accordingly. Bob Weber in favour of any increase; J. Erickson agrees

> that there is little point in trying for additional extrusion price increase; W. Stracey feels we are brave to try to increase at this time. John Parsons of Daymond is happy and will go along. Tony Kingsmill will follow same.'"

Various persons referred to in the memo were employees of competitors.

This document was a cornerstone of the Crown's case and on the surface looked very damning. It pointed to an agreement to "carry over" an extrusion ingot price increase into extrusion prices. However, defence witnesses testified that there was no agreement but rather an exchange of views. The author testified that he did not make all the calls to the others personally. Some calls were made by his staff. The responses he and his staff members received were to the effect that the ingot price increase could not be avoided but the extruders could not absorb the additional cost and would have to reflect it in the price of extrusions. The author further testified that no agreement was elicited or made. Some of the parties alleged to have been spoken to confirmed that the author had not spoken to them. The trial judge found that some of the statements in the memo were heresay.

Although under S.69 the memo was admissible and would make *prima facie* proof of the statements recorded in it, the judge was convinced, after having heard the evidence of all of the persons mentioned in the memo, that very little weight could be attached to it. Had the author or others not been available to testify, the accused may well have been placed in a very disadvantageous position.

5.06 Defence Evidence

Unsuccessful efforts have been made by accused parties to obtain the benefit of S.69. The use of the Section has been reserved to the Crown. Roach, J.A. in *Regina v. Howard Smith Paper Mills Limited et al*, [1955] O.R. 713 (Ont.C.A.) at p. 721 was of the opinion the Section was enacted in order to assist the Crown. In *Anthes* (1974) 19 C.C.C. (2d) 394, Grant, J. referred to the fact that subsection (2) commenced with the words "in a prosecution under Part V". He stated that the word "prosecution" may be used to designate the presentation of the Crown's case as distinguished from evidence offered by the defence. In addition, he concluded that the language of the whole section related to matters which ordinarily the defence would not seek to prove. He continued at p.406:

> "It does not seem to me that Parliament could have intended to constitute as *prima facie* proof of the matters set out in s.45 [now s.69], writings tendered by the defence which are essentially self-serving and which could so easily be fabricated by an accused."

Pennell, J., in *Canadian General Electric* (1974), 17 C.C.C. (2d) 433, similarly held that the evidentiary effect of the Section did not extend to documents tendered in defence. He indicated that to hold otherwise would be to ignore the history of the Section. He found that there was nothing in the language or the history of the Section which placed documents tendered by an accused within the scope of its operation. He also was of the view that to recognize such a claim might easily clog the proceedings with self-serving documents.

5.07 Relevance

In *R. v. British Columbia Sugar Refining Company Limited* (1960), 32 W.W.R. (N.S.) 577 (Man.Q.B.), the court concluded at p. 630 that it is the duty of the court in a criminal prosecution to scrutinize legislation which departs from what are usually considered the well-established rules of evidence, to interpret such legislation strictly and to give the accused the benefit of the doubt as to its effect and application to the individual case. Williams, C.J.Q.B. determined that S.41 (now 69) did not make evidence which is irrelevant, relevant or admissible. He said that even if such documents ar required to be admitted without further proof, the court is bound to reject the evidence if it is irrelevant and otherwise inadmissible. These remarks were adopted in *R. v. K.C. Irving Ltd.* (1974), 13 C.P.R. (2d) 115 at 122 (N.B.S.C.).

5.08 Hearsay

A contentious issue is whether hearsay statements contained in records are admissible under S.69. Prosecutors, relying heavily on the actual wording of S.69, argue that the only exclusionary rule applying to S.69 documents is the test of relevancy. However, the introduction of hearsay evidence is not in keeping either with the intention of the Section nor with sound and fair criminal procedure. As stated earlier, S.69 was introduced to overcome some of the difficulties which were apparent from the *Ash-Temple* case [1949] O.R. 315. Hearsay was not the problem in that case and the refusal to admit hearsay evidence contained in a record tendered under Section 69 is not inconsistent with the real purpose for which the provision was introduced. There is no sound basis for saying that hearsay should be introduced when it is contained in a S. 69 record, when it would not otherwise be admissible. Such further intrusion into the usual rules of evidence should not be made unless Parliament has clearly required it.

Pennell, J. in the *Canadian General Electric* case (1974), 17 C.C.C. (2d) 433, after a review of authorities, stated at p. 494:

> "It remains for me to consider the evidentiary effect and relevancy of documents tendered by the Crown pursuant to s.45 [now s.69]. I must determine the evidentiary effect to be given to acts and statements described within such documents which are hearsay and not within the personal knowledge of the 'agent' or 'participant' recording those facts.
>
> The question is not altogether novel. ...So viewing it, I think that hearsay was not meant to be *prima facie* proof by an inference from s.45. ...

> I hold the view that s.45 is meant to be a procedural tool to assist the Crown but it was not meant to make *prima facie* true that which could not be considered true had it been given by direct evidence. Let me illustrate. Hearsay recited within a newspaper clipping attached to a document proved to have been on premises occupied by an accused, may be admitted under s.45 as *prima facie* proof that the accused had knowledge of the contents of the clipping but it would not be '*prima facie* proof' of anything said, done or agreed to by the accused. I do not think that Parliament meant by that feat of enactment, radically to change the weights and balances in the scales of criminal justice. Although s.45 eases the prosecution's path to a conviction, I think it does not relieve the Court from the duty of rejecting evidence if it is irrelevant and otherwise inadmissible, merely because it is contained in a document that is admissible.

Rothman, J. adopted this reasoning in the *Aluminum* (1976), 29 C.P.R. (2d) 183 case at p. 200:

> "However far-reaching s.45 may be, I do not consider that its effect is to make proof of hearsay. Quite clearly, it requires that the document be admitted into evidence. The document could, of course, make proof of what Clement recorded if he himself were able to give direct evidence of what was recorded. But if he did not himself speak to some of these people, he would be unable to give direct evidence of any 'agreement' made with them so that it is difficult to conceive how the document can be accepted as proof of such an agreement."

Canadian General Electric was similarly followed in *R. v. Lethbridge Concrete Products et al* (1979), 24 A.R. 335 (Alta.S.C.) and in *Cominco*.

In *Cominco* [1980] 2 W.W.R. 693, the Crown argued that documents tendered under S.69 which contained hearsay were admissible and made *prima facie* proof of their contents but could be refuted by other credible evidence. The fact that the documents contained heresay evidence was said to affect the weight but not the admissibility of the documents. It was further argued that the wording of the Section itself supported the Crown's position in that if Parliament had intended to exclude hearsay statements, it would have done so instead of enacting the broadly-worded Section. Reference by analogy was made to S.30 of the *Canada Evidence Act*, where Parliament did limit its application to situations "where oral evidence in respect of a matter would be admissible in any legal proceeding." Under this reasoning, since Parliament made no such limitation when enacting S.69, the wording did not permit the outright rejection of heresay statements in such records.

Brennan, J.'s comments concerning this issue in *Cominco* are obiter. He said at p.719 that while any document which meets the requirement of the subsection, including any hearsay contained therein, should be admitted in evidence, he did not agree with the Crown's submission that hearsay evidence should be accepted as proof of that which it states unless contradicted by other acceptable and credible evidence.

In the *Abitibi* case (1961), 36 C.P.R. 188, Batshaw, J. said at p.193 that he had ignored any parts of the documentation which appeared to him to be hearsay.

5.09 Opinion Evidence

In general, opinion evidence may only be given by an expert. The Crown has argued that opinion evidence in documents otherwise admissible under S.69 should be accepted as proof even though not given by an expert. Many of the same authorities relied upon by the Crown to support the admission of hearsay evidence in these circumstances, have been relied upon here as well.

In *British Columbia Sugar*, the trial judge rejected opinion evidence as being irrelevant. Mackay, J. in *Atlantic Sugar* concluded various opinion statements by third parties were irrelevant and inadmissible even though, if contained in a document, the document must be admitted under Section 45. Houlden, J.A. in *Anthes* (1975), 26 C.C.C. (2d) 349 at p. 386 indicated that some of the statements in the documents were clearly expressions of opinion but were nevertheless admissible. Once admitted, its weight was a matter for the trial judge.

It is submitted that opinion evidence not normally admissible except through an expert should not be accepted as *prima facie* proof under S.69. This goes beyond the corrective measures intended by the enactment of the Section.

5.10 The Charter

Not surprisingly, the courts have been urged to find that S.69 offends rights established in the 1982 *Charter of Rights and Freedoms*. In *R. v. Metropolitan Toronto Pharmacists' Association*, unreported, May 4, 1983 (Ont.H.C.), Van Camp, J. ruled that S.69 was not invalid by reason of the Charter. It was determiend that S.45 was not a reverse onus section and that the presumption of innocence was not displaced.

In *R.L. Crain Inc. et al. v. Couture et al.* (1983), 6 D.L.R. (4th) 478, the Saskatchewan Court of Queen's Bench reached the same conclusion. In that court, the applicants argued that S.69, in authorizing the blanket introduction of documentary evidence, without such evidence being proven as a fact, was a violation of Section 7 of the *Charter*. It was also argued that the section raised a *prima facie* presumption with regard to documentary evidence that was inconsistent with the presumption of innocence guaranteed by Section 11(d). Scheibel, J. denied the applicants relief under the *Charter*. He considered it unnecessary to deal with Section 7 as the applicants had not then been charged. Section 11(d) was found not to have been violated since the judge was of the opinion that the *prima facie* presumptions arising under the Section were of the permissive type, being inferences that may, not must, be drawn when a basic fact is proved.

However, two lower court judgments in Ontario did find the provision unconstitutional. The first was *R. v. Dave Spear Limited et al.*, unreported, August 23, 1985 (Ont.Prov.Ct.). In that case, the *prima facie* proof provisions of Section 45(2)(c)(ii) were held to be unconstitutional. The second was

Regina v. Independent Order of Foresters (No. 2) (1986), 14 C.P.R. (3d) 254 (Ont.D.C.). Section 45(2)(c) of the *Combines Investigation Act* was attacked as being unconstitutional based on Section 11(d) of the *Charter* in that it was available for use only by the Crown and it created mandatory presumptions, which forced an accused to disprove them. The difference in wording between "be deemed" in Section 45(2)(a) and (b) and "prima facie proof" in Section 45(2)(c) was noticed. "Prima facie proof" was found to be a standard of proof where the fact is proved sufficiently for conviction if the accused deduces nothing to contradict the fact or to raise a reasonable doubt. "Be deemed" is lesser standard and conviction need not necessarily follow if the accused stands silent.

Whealy, D.C.J. concluded that the documents which were the subject of the *prima facie* state of proof may be documents proving the *actus reus* or *mens rea* of the offence, thus displacing the presumption of innocence guaranteed by Section 11(d) of the *Charter*. He disagreed with the prosecution that Section 11(d) of the *Charter* deals only with mandatory presumptions. He concluded that it deals with permissive presumptions, which are arbitrary in the sense that the presumed fact is not the natural inference from the proven fact. Because of the large class of persons who can be participants and because Section 45(2)(c) established a level of proof where a conviction will ensue in the absence of evidence to the contrary, the conclusion was that Section 45(2)(c) offended Section 11(d) of the *Charter* and was of no force and effect, unless saved by Section 1. The court did not go on to consider Section 1.

5.11 Copies of Records

Under S.20 of the *Competition Act*, copies of records obtained or received by the Director are, upon proof orally or by affidavit that they are true copies, admissible in evidence in any proceedings under the Act and have the same prohibitive force as the originals. Where such proof is offered by affidavit, it is not necessary to prove the signature or official character of the deponent, if that information is set forward in the affidavit, or to prove the signature or official character of the person before whom such affidavit was sworn.

This provision makes good practical sense. This is the age of the photocopier. In most cases, provided the copies are legible, there is no need to go through the expensive and time-consuming exercise of calling a witness to say the records were photocopied and are true copies, or alternatively, to go through the exercise of introducing original records in the proceedings. It is open to the Crown or an accused to subpoena the party who swore the affidavit if points of contention arise. If any question arises as to the authenticity of the record or the accuracy of the copies, discussion with Crown Counsel should on most occasions result in the original records being produced for examination by defence counsel, provided they exist.

5.12 Admissibility of Statistics

Sections 70-72 of the *Competition Act* further assists the Crown in dealing with the admissibility of statistical evidence. Section 70 provides that a collection, compilation, analysis, abstract, or other record or report of statistical information prepared or published under the authority of the *Statistics Act* or any other enactment of Parliament or of a legislature is admissible in evidence. Prior to the enactment, the Ontario High Court in *Northern Electric* [1955] O.R. 431 determined that reports of the Dominion Bureau of Statistics were not made admissible by the *Statistics Act* and were not admissible as public documents within the exceptions to the hearsay rule.

Under S.70(2), the Minister of Consumer and Corporate Affairs or the Director may request the Chief Statistician of Canada or an officer of any department or agency of the Government of Canada, the functions of which include the gathering of statistics, to compile statistics relating to any industry or sector. Such statistics are admissible in evidence. Similarly, the Minister or the Director may request an officer of any department or agency of a provincial government, the functions of which include the gathering of statistics, to make a similar compilation. That compilation is also admissible. Section 70(2) requires the federal officials to comply with such a request but there is no power under the *Competition Act* to direct the provincial officials to comply.

A certificate purporting to be signed by the Chief Statistician of Canada or the officer of the department or agency of the Government of Canada or of a province under whose supervision a record, report or statement of statistics was prepared, setting out that the attached material was prepared under his supervision, is evidence of the facts alleged therein without proof of a signature or official character of the person by whom it purports to be signed.

Section 71 provides that statistics collected by sampling methods by or on behalf of the Director of any other party to a prosecution is admissible in evidence. However, under S.72, before the statistical evidence referred to in sections 70 and 71 will be admitted, reasonable notice must be given to the parties against whom the evidence is produced together with a copy of the statistics and, in the case of statistics referred to in S.70, the names and qualifications of those persons who participated in the preparation. Parties against whom statistics referred to in S.70 are produced may require for cross-examination, the attendance of any person under whose supervision the material was prepared. Any person against whom the statistics referred to in S.71 are produced may require for cross-examination the attendance of any person who participated in the preparation of the material.

6.0 CONSCIOUS PARALLELISM

The law in Canada is relatively clear that conscious parallelism is not unlawful. Conscious parallelism has been described as one of the great battlefields of anti-combines litigation: *Canadian General Electric* (1974), 17 C.C.C. (2d) 433 (Trial); 34 C.C.C. (2d) 489 (Appeal).

This concept has provoked a great deal of discussion among economists and competition authorities. The issue of whether conscious parallelism should be prohibited or controlled is a continuing debate in Canada. At times, conscious parallelism has proven to be a valuable tool for the accused faced with evidence that prices of all principal competitors in a market are the same or virtually the same.

Economists have described conscious parallelism in various ways. Some of these are reviewed by Stanbury and Reschenthaler in "Oligopoly and Conscious Parallelism: Theory, Policy and The Canadian Cases" (1977), 15 *Osgoode Hall Law Journal* 617. In those Canadian cases where the issue of conscious parallelism has arisen, the courts have frequently heard economists explain the concept. No definitive meaning or explanation has been adopted by the Canadian courts. However, various judges have referred to the explanations given by various economic witnesses and have not expressed serious disagreement about its meaning.

A key question is whether conscious parallelism itself signifies an agreement among the accused. If not, what more is needed to establish an unlawful agreement? Also, to what extent can the concept assist either the Crown or defence in a charge of conspiracy?

In 1962, Mr. Henry, then the Director of Investigation and Research (now Mr. Justice Henry), in an address to the Public Buyers Group of British Columbia, stated:

> "...we find an industry having a small number of competito[illegible]. who by reason of their small number know a good deal about each others businesses and particularly about the way each is likely to react to given market changes. ...Here we find the phenomenon which has been called in some anti-trust circles 'conscious parallelism' or the tendency on the part of a small group of firms constituting an industry to act more or less in a uniform manner.
>
> Here is an example of a situation that may, without collusion, bring about the same result as if there were collusion. It may be that in such an industry characterized by the oligopoly of which I am speaking, one of the firms will act as a price leader and his pricing policies will tend to be adopted by the others. Conscious parallelism, if conducted without collusion among the members of the industry, is not an offence. This is because if such collusion is not present, there is not the element of agreement or arrangement necessary to constitute the offence of conspiracy. I must emphasize, however, that this is so only in the absence of collusion.
>
> ...
>
> It is generally recognized by economists and businessmen that, in a market where there are only a few firms supplying a homogeneous product, any difference in the prices at which the firms regularly sell the product can be only temporary unless some unusual factor is present. Any such seller, for example, will find it

> difficult to market goods at a higher price than that at which his competitor is offering the product so long as the latter is able to supply the market. Unless a decision to reduce a price is considered unsound by those controlling the larger part of the production for the market, each price reduction by one of few sellers is likely to be followed by competitors and the firm initiating the price reduction may simply retain its original share of the market at a lower margin of profit. If the market shares held by the several sellers are altered in the process, a seller whose share has decreased may attempt to regain his original position by a further price cut, and additional rounds of price cutting may follow.
>
> Sellers in a market where there are few competitors are generally aware that attempts to enlarge their shares of the market by price cutting may result in rapid deterioration of price stability and substantial reduction of profits. They therefore tend to avoid any action which might put a chain of price cuts in motion. As long as the price structure is not disturbed by others, they are reluctant to make any price concession that might be detected by a competitor; this is particularly true if there is nothing in the business subject to quotation which sets it apart from the type of business ordinarily done by the firm, and in contemplation of which list prices were established.
>
> ...
>
> Where conditions are such that each seller is likely to conclude that a quotation below list involves a threat to future profits which outweighs the immediate advantage of gaining the particular order, identical tenders may be received from all suppliers without any collusion among them."

It seems clear that conscious parallelism can arise without collusion. This position has not only been put forward by the Director but has been accepted by Canadian courts. A comment by Pigeon, J. in *Atlantic Sugar* [1980] 25 S.C.R. 644, has muddied the water somewhat on this issue, but it is submitted that the better view is that it can certainly exist in the absence of collusion.

6.1 Canada Cement Lafarge

Not surprisingly, businessmen as well as judges have accepted what Mr. Henry has said on this subject. In Regina v. *Canada Cement LaFarge Ltd. et al* (1973), 12 C.P.R. (2d) 12, the accused were discharged by Provincial Court Judge Camblin. On reviewing the evidence, he was of the opinion at p.17: "...that the resulting prices set by the companies are the result of conscious parallelism and the companies are therefore discharged."

Prices for cement sold by or for the accused companies were found, with negligible exceptions, to be the same. Also, cement was found to be a homogeneous product. The particulars of the Information provided, in part, that the accused conspired, combined, agreed or arranged together by adopting a basing-point system of delivered pricing which they continued to use. This system included a base price for each cement plant of the accused, which when taken together with an agreed mileage allowance from one such plant to the delivery destination, regardless of the actual source, yielded a uniform delivered price of cement and related products of any accused at each delivery point affected by the conspiracy.

Judge Camblin concluded (1973), 12 C.P.R. (2d) 12 at p. 14: "Defence counsel, I am sure, will agree that the Crown has established that the companies involved are using a base freight factor pricing system which did not come about by mere coincidence." It is unclear what is meant by this comment. It is uncertain whether the judge was implying the system came about through conscious parallelism, or alternatively, by agreement among the accused. The judge acknowledged that the remarks by Mr. Henry were of great assistance to him. One would conclude that notwithstanding his comment concerning the lack of coincidence, the learned judge must have determined that there was not sufficient evidence of an agreement among the accused to commit them for trial. The judge quoted at length Mr. Henry, who emphasized that only in the absence of collusion is conscious parallelism not an offence.

Although this lower court decision did not contribute substantially to the analysis of conscious parallelism, it has been quoted in subsequent cases and in at least one reported decision, *Aluminum*, formed the basis of a discharge of the accused at a preliminary hearing on a charge of conspiracy where, again, the speech of Mr. Henry was referred to by the judge.

6.2 Aluminium

In *R. v. Aluminum Co. of Canada Ltd. et al.* (1975) 22 C.P.R. (2d) 216, at the preliminary hearing, Alcan was found to have instituted price increases which were followed by the co-accused. Joncas, J. queried whether two particular price increases, to which the co-accused consented, were designed to prevent or unduly reduce competition. He concluded that competition among the accused was very strong before, during and after the price increases and he discharged the accused.

The basis for the discharge is again unclear. There is uncertainty as to whether the conclusion was reached because there was insufficient evidence of an agreement or alternatively insufficient evidence of other elements of the offence. The emphasis on the remaining competition would suggest that even if there was sufficient evidence of an agreement, the judge was of the view that other elements of the offence were not established.

Following the discharge of the accused at the preliminary hearing, the Crown proceeded by way of direct indictment and the case proceeded to trial in the Quebec Superior Court. The Crown contended that the five accused aluminum extruders conspired to pass on to their customers an increase in the price of aluminum extrusion ingot.

For many years Alcan had published a price list which was sent to its customers. Several of the accused had price lists which were similar to the Alcan list and all of the accused used the Alcan list as a guide to their pricing. The prices on these lists were not intended to be the prices to be paid by customers but rather a maximum price from which salesmen could discount.

There was no evidence that common or similar prices were quoted or charged by the accused.

The Crown contended that the fact that the accused intended to use and follow Alcan's price list and that most of the accused announced a further increase after the date in question, tended to support the conclusion that a conspiracy existed. Also, the Crown pointed to the fact that the accused were on the Alcan mailing list and received copies of its price lists. There was no evidence to suggest that there was any agreement to follow Alcan's price list or any attempt or device to enforce such an agreement.

The court heard economic evidence that price leadership is a common occurrence but that where the actual prices differ from list prices and differ significantly from each other, there is no real price leadership and no reason to presume collusion.

The accused were acquitted. The judge said that it was not unreasonable to conclude that the price increases announced by the accused resulted not from an agreement but from independent decisions made to cover increases in metal costs. He concluded (1976) 29 C.P.R. (2d) 183 at p. 206 that the use of Alcan's price lists by other competitors and the exchanging of price increase announcements did not lead necessarily to the conclusion that there was an agreement. There was no discussion of conscious parallelism in the judgment.

6.3 Armco

The *Armco* (1974) 21 C.C.C. (2d) 129 (Trial); (1975) 24 C.C.C. (2d) 147 (Appeal) case dealt in some detail with price leadership and conscious parallelism. The thrust of the prosecution's case was as follows: the corrugated steel pipe fabricating industry was suffering problems in 1962-63; in those two years, a concerted attempt was made by the accused and their co-conspirators under the aegis of the Corrugated Steel Pipe Institute to unduly lessen competition by an agreement or arrangement whereby they would abide by the price list of the "price leader" at any particular time; having accomplished this arrangement, prices with the exception of occasional variations were stabilized; when a newcomer appeared in the industry, uniformity of bidding in prices disappeared; this was followed by a preponderance of uniformity in prices which were demonstrated by uniform or identical price lists and quotations.

Substantial effort was directed by the Institute to devise some formula whereby stability of prices could be brought to the industry to eliminate cut-throat competition and achieve orderly marketing. The problem facing the industry through the Institute was to accomplish this without contravening the *Combines Investigation Act*. An open-price policy was advocated under which each firm would openly set out its prices in written or printed form, including discounts and terms of credit, and make these available to all customers, competitors and the public. Substantial efforts were made to achieve this open-price policy and once it was obtained, stability of the market followed.

The conclusion of Lerner, J. was that plan or policy and the parallel conduct that followed in fact resulted from a tacit agreement. He reviewed the evidence at considerable length and analyzed it with a view to determining the extent to which there was communication among the accused in the implementation and continuation of the open-price policy. The accused were convicted. Lerner, J. (1974) 21 C.C.C. (2d) 129 at p. 141 recognized that the open-price policy: "...might result by osmosis or as learnedly expressed by the advocates of the scheme of 'open price policies' as 'conscious parallelism' and certainly must not result from tacit agreement."

In the course of efforts to implement and continue the open-price policy, members of the industry were in communication with Mr. Henry, the Director of Investigation and Research. Mr. Henry clearly indicated that in his view the efforts that were being made to secure and maintain the policy were accompanied by considerable risk. One of Mr. Henry's letters referred to at p.147 of the Reasons states:

> "'But it appears to me that the points made in your speech concerning the adoption of a policy of price leadership or conscious parallelism (sic. follow the leader without persuasion or agreement, tacit or otherwise) goes far beyond what is contemplated by the pamphlet. It is one thing for such oligopoly characteristics to develop of themselves without collusion; it is quite another matter for members of an industry to make a conscious effort collectively to bring them about. I feel bound, therefore, to say that these developments, going as they do in my view beyond the purport of the pamphlet, could have the effect of leading members of the industry to becoming parties to an unlawful conspiracy.'"

This statement largely summarizes what Lerner, J. eventually found to have been the situation, namely, that price leadership or conscious parallelism did not in this case develop naturally through market forces. Instead, the members of the industry made a conscious effort collectively to bring about this situation and in the course of so doing became parties to an unlawful conspiracy.

While the accused had been warned by members of the industry not to contravene the *Combines Investigation Act*, each was urged to independently adopt the open-price policy. An example of such urging was in the address by Mr. Russell which included the following statement referred to (1974), 21 C.C.C. (2d) 129 at p. 149:

> "'Industry knows a good deal about each other's businesses and particularly, about the way each is likely to react to given market changes. Here we find the phenomenon which has been called in some anti-trust circles 'conscious parallelism' or the tendency on the part of a small group of firms constituting an industry to act more or less in uniform manner. One of the firms will act as a price leader and his pricing policies will tend to be adopted by the others. Conscious parallelism, if conducted without collusion among the members of the industry, is not an offence.

> This is because if such collusion is not present there is not the element of agreement or arrangement necessary to constitute the offence of conspiracy.'"

Mr. Russell's conduct was interpreted by the court as urging the industry to adopt conscious parallelism rather than leaving the adoption of such a phenomenon to ordinary market forces. The accused were urged not to collude but at the same time to adopt the policy. The two positions were inconsistent.

The extent to which the Institute went in its efforts are illustrated by the Craig-Allan Report prepared by two directors of the Institute who conducted a fact-finding mission to determine how the ills of the industry could be overcome. The Report contains statements such as the following at p.156:

> "'It is significant, however, that the industry, if it is to stay healthy and keep its capacity for being further inflated, must achieve price stability ...
>
> Price stability is synonymous with published pricing and the latter must be adopted and cherished by this industry.
>
> It is the only legal way of communication among members of the industry providing it is done without collusion.'
>
> ...
>
> 'Managements must immediately initiate within their own sales organizations the practice of adhering to their published prices. Managements must then give urgent considerations and study to their published prices...
>
> It should be possible with a series of changes in published prices and appropriate leadership by certain management relative thereto that proper price levels commensurate with factors outlined in (1) can be achieved within two to three months.'"

Lerner, J. found the Report masterful in the language used to urge an agreement without appearing collusive.

Perhaps not surprisingly, he found that the only sensible, reasonable and consistent inference to be drawn from this document is that it was an exhortation to the members of the industry to agree to uniform published prices by following appropriate leadership by management. Other evidence was equally strong. There was evidence, for example, that in lieu of a discount being granted by one party, which would have made tender prices unequal, that party was prepared to make a contribution to a charity of the customer's choice.

In convicting the accused, Lerner J. (1974), 21 C.C.C. (2d) 129 states at p. 177:

> "It would offend one's common sense after reviewing the history which I detailed earlier in this judgment, not to arrive at the irresistible conclusion and beyond a reasonable doubt that an arrangement was finally achieved between the members of the Institute to have, as Turney put it, price 'leadership' and 'followership'. With the difficulty experienced over the first 10 or 11 months of 1963, in 'educating' the industry, the sudden achievement of open price policy within two weeks of the

> publication of the Robertsteel price list on December 2, 1963, could only occur if there was an arrangement or agreement. The many warnings, admonitions and exhortations of Campbell, Russell, Yeo, Turney, Craig and Allan that each company was to arrive at its own independent conclusion without collusion or coercion from other members of the industry reminds one of the line from Hamlet: 'The lady doth protest too much, methinks.'
>
> ...The publication of this price list by itself was innocent conduct but common sense dictates that it would be unlikely, if not impossible, that this progressive and energetic competitor would risk another failure without assurances from other members of the Institute that, if attempted again, it would be followed by the others. The simple fact that stability was almost instantaneous makes any other inference not only improbable but unrealistic."

The risks of dialogue and communication among competitors are clearly illustrated. Evidence of communication among competitors is always meticulously reviewed in conspiracy cases under the *Competition Act*. Such communication will always be accompanied with the suspicion of improper dealing. This is illustrated by the comments of Lerner, J. at p.183:

> "Normally, competitors in any particular industry avoid dialogue with competitors. This would apply in an industry where there are homogenous products or the presence of an oligopoly (a few companies or producers making the same product). ...However, with the indistinguishable characteristics of culvert manufacture, to which was added the limited market in which it was sold and used, these manufacturers would therefore, of necessity, be engaged in devising methods, procedures and even schemes to take as much of the market as possible from each other. Common sense would dictate that it would be vital to contain the secrets of one's own operation.
>
> ...
>
> One might very well ask: what possible purpose could this whole effort towards establishing the open price policy be if it were not to arrange something that would achieve stability of prices, eliminating competition and resulting in orderly marketing as against what was presently the situation that the industry found intolerable?"

This case confirms that conscious parallelism in the absence of an agreement or collusion is not unlawful. Lerner, J. (1974), 21 C.C.C. (2d) 129 stated at p. 187:

> "The 'open price policy' is an ambitious theory and if effected and if carried out successfully, would achieve the ultimate and still not offend the *Combines Investigation Act*. Even if it were to result in unduly lessening competition, it would not offend the Act because there would have been no agreement or arrangement, direct or tacit. Once all members of the industry understood and recognized the value of this approach to marketing there would be a universal conscious effort on the part of all to actively follow the price lists and ancillary or collateral marketing devices of the 'leader'. There would result a conscious effort to 'parallel' or follow the leader. Hence the expression 'conscious parallelism' as found in the published material distributed among the accused."

However, those who advocate controls on conscious parallelism may be encouraged by the following statement of Lerner, J. at p.188:

> "These reasons are not intended to lay down any definitive pronouncement on whether conscious parallelism is contrary to the *Combines Investigation Act*, but by way of *obiter*, economists to the contrary, I fail to see on a common-sense basis how conscious parallelism could be achieved without a conspiracy on the part of the accused to come to an agreement or arrangement beforehand. That occurred in this case notwithstanding that the ideal characteristics of an oligopoly were present. As stated in the letter dated April 26, 1963, from the director of investigation and research, D.H.W. Henry, to Mr. Russell (ex. 43):
>
> > 'It is one thing for such oligopoly characteristics to develop of themselves without collusion; it is quite another matter for members of an industry to make a conscious effort collectively to bring them about.'"

This is a curious passage. Having said that he failed to see on a common-sense basis how conscious parallelism could be achieved without conspiracy, Lerner, J. then appears to adopt the statement of Mr. Henry, which indicates that such a characteristic could appear without collusion. It may be that the learned judge was highly influenced to make this statement by the strong evidence of collusion before him. Even though the industry was an oligopoly, pricing had been chaotic and there was no conscious parallelism in the industry prior to efforts being made by the participants to bring about such a system. The collusive conduct in this case had obviously brought about parallelism within a very short period of time and in the absence of natural market forces.

The *Armco* case proceeded to the Ontario Court of Appeal, where the appeal was dismissed (1975) 24 C.C.C. (2d) 147. The Court of Appeal did not deal with the concept of conscious parallelism other than to comment on the nature of the evidence that was before the trial judge.

6.4 Atlantic Sugar

Conscious parallelism was argued in *Atlantic Sugar* which has proven to be one of the most troublesome cases in recent Canadian competition law.

The accused were charged with two offences. The first was conspiracy to prevent or lessen competition unduly. The second was conspiracy to enhance unreasonably the price of raw and refined sugar. At trial, the accused were acquitted on both counts. The appeal was dismissed with respect to the first count but a conviction was entered on the second. In the Supreme Court of Canada, the acquittals on both counts were restored.

One of the propositions advanced by the Crown was that in 1960 Redpath, an accused, adopted a base stock system for the pricing of refined sugar. It was alleged that the resulting price list was invariably, simultaneously and exactly followed, item by item, by the other two accused, although actual freight costs differed for each refiner. The defence theory advanced was that the base stock system, regardless of its merit, was conceived solely by Pate and Lyle and its subsidiary, Redpath, and was simply copied by the other two accused. In addition, the accused argued that identical price lists were not necessarily evidence of collusion to fix prices but were an example of price leadership without prior arrangement, tacit or otherwise.

The court concluded that the base stock system for pricing the refined product was introduced at Redpath and Tate and Lyle, whose employees took over the management of Redpath. When the other accused learned of the system, they immediately adopted it. After adopting the base stock system, Redpath prepared and published price lists. As soon as the others learned how Redpath was pricing its refined sugar, they used the same formula for pricing their product. The court was faced with the question of whether or not the uniform price lists resulted from an agreement among the accused.

With respect to conscious parallelism and price leadership, Mackay, J. stated at (1975), 26 C.P.R. (2d) 14, p. 96:

> "Price conformity and identical price lists are characteristic of an oligopolistic industry--one in which there are but a few manufacturers--and may well be consistent with independent competitive decisions. If price conformity is achieved through an agreement, even a voluntary, uncoerced, tacit agreement, then price conformity is a collective arrangement likely to prevent competition unduly: *R. v. Northern Electric Co. Ltd. et al* ...
>
> On the other hand, if conformity is the result of price leadership by the industry leader and a conscious effort by other members of the industry to follow the leader, to parallel its prices, then, although the result might be an undue prevention of competition, 'it would not offend the [Combines Investigation] Act because there would have been no agreement or arrangement, direct or tacit': Lerner, J., in *R. v. Armco Canada Ltd. and 9 other Corporations* ...".

It is of interest to note that Mackay, J. is of the mind that Lerner, J. in *Armco*, supported the position that price leadership and conscious effort by the other members of the industry to follow the leader and parallel their prices would not offend the Act because there would have been no agreement.

Mackay, J. (1975), 26 C.P.R. (2d) 14 at p. 98 considered the further statement in *Armco*, where Lerner, J. stated by way of *obiter dictum* that: "'...economists to the contrary, I fail to see on a common sense basis how conscious parallelism could be achieved without a conspiracy on the part of the accused to come to an agreement or arrangement beforehand.'" Understandably, Mackay, J. found that this statement seemed to contradict the other statements of Lerner, J.

Mackay, J. went on (1975), 26 C.P.R. (2d) 14 at p. 98 to quote from the American case, *Delaware Valley Marine Supply Co. v. American Tobacco Co. Ltd et al* (1961), 297 F. 2nd 199 at 202-203:

> "'Conscious parallelism, relied on heavily by the Plaintiff here, is of aid in determining the existence of sophisticated and silent agreements which so often have injuriously restrained trade. But conscious parallelism is not yet a conclusive legal substitute for proof of conspiracy. It is circumstantial evidence the probative value of which necessarily varies with the kind of parallelism and the factual setting where it is found.'"

In addition, at p.98 he quotes from an article in 75 *Har. L. Rev.* 655 (1962), by Donald F. Turner as follows:

> "'...conscious parallelism is not even evidence of agreement unless there are some other facts indicating that the decision of the alleged conspirators were interdependent, that the decisions were consistent with the individual self-interest of those concerned only if they all decided the same way.'"

The accused were acquitted. The judge said that since the Act did not prohibit a member of an industry from taking into account and following its competitors' price changes, be they up or down, it follows that it is not prohibited from taking into account and following the system upon which these changes are made. Mackay, J. did, however, make the statement at p.102 that:

> "Thereafter, each of the accused settled down to a policy of maintaining their traditional market shares. Although each stressed that this was the result of an independent decision, one would be ingenuous not to be aware that there was and continues to be a tacit agreement to this effect."

However, the judge concluded that it was not shown that the agreement was arrived at with the intention of unduly preventing or lessening competition. Mackay, J. further said that he was not able to infer that market shares were maintained for the purpose of stifling competition.

The conclusion of Mackay, J. concerning the necessary intention for the offence was found by the Court of Appeal to be an error of law (1978), 41 C.C.C. (2d) 209. The Court of Appeal decision was subsequently reversed by the Supreme Court of Canada [1980] 2 S.C.R. 644 and the acquittals restored.

The Court of Appeal noted that although the trial judge found that an agreement to lessen competition would be tantamount to extinction of competition and would be undue, he did not convict the accused. The reason for this was that he concluded that it was not proven there was an intention to unduly lessen competition. The accused would have been found guilty were it not for this error of law. Mayrand, J.A. comments (1978), 41 C.C.C. (2d) 209 at p. 229 on the subject of conscious parallelism:

> "Thus, the uniformity of the prices of sugar sold by the respondents, as suspect as they are, have been explained to the satisfaction of the Judge. ...The conformity of prices set by St. Lawrence and by Atlantic to Redpath's price would thus be explained by an action which is parallel and conscious but not concerted, rather than by a conspiracy of the respondents to maintain or to unreasonably raise the price of sugar: ... The Judge, in the exercise of the discretion which is given to him, having found these explanations satisfactory, reaches the following conclusion which appears to me to be justified [emphasis added] ... [p.100]:
>
> > 'Since the Act does not prohibit a member of an industry from taking into account and following his competitors' price changes, be they up or down, it

> follows that he is not prohibited from taking into account and following the system upon which these price changes are made.'"

In the Supreme Court of Canada, Pigeon, J. stated [1980] 2 S.C.R. 644 at p. 656:

> "It must be accepted that a conspiracy may be effected in any way and may be established by inference. In dealing with the refiners' uniform prices, the trial judge felt that they raised an inference of collusion. However he accepted (at p.98) that this was a result of independent decisions called 'conscious parallelism' which is not illegal. The evidence was clear, however, that not only were its competitors immediately aware of Redpath's list price the moment a new price was posted in its lobby, they also in time were able to discover Redpath's pricing formula by a process of deduction from available data. Yet the trial judge held, correctly I think, that this did not constitute a conspiracy to maintain uniform prices according to Redpath's formula but merely 'conscious parallelism'. Could this not be just as accurately called 'parallelism by tacit agreement'?"

The meaning of the last comment is also unclear. Having agreed with the trial judge that uniform prices did not indicate a conspiracy, but instead constituted conscious parallelism, Pigeon, J. queried whether this could not be just as accurately called "parallelism by tacit agreement". Was Pigeon, J. questioning whether or not conscious parallelism could come about other than by way of tacit agreement? He proceeded to confirm that none of the refiners were obliged to compete more strongly than they felt desirable in their own interest. He indicated that each refiner was entitled to decide not to seek to increase its market share as long as this was not done by collusion and that the trial judge was right in coming to the conclusion that the "tacit agreement" to maintain market shares was not an agreement to lessen competition unduly.

Although there is uncertainty as to the meaning of this statement, it is submitted that the better view is that conscious parallelism may occur in the absence of an agreement.

Estey, J. dissented in *Atlantic Sugar*. He commented on conscious parallelism [1980] 2 S.C.R. 644 at p. 675 but confined his remarks to noting that the defence was not advanced under count 2 and formed no part of the judgments below.

6.5 Large Lamps

In *Canadian General Electric* (1974), 17 C.C.C. (2d) 433, various manufacturers of large lamps were charged with two counts of monopoly and one of conspiracy. Acquittals resulted on the monopoly charges. The accused were convicted of conspiracy. The Crown alleged that the accused agreed or arranged to adopt simultaneously and follow religiously a virtually identical sales plan for the distribution and pricing of large electric lamps. The accused contended that there was no agreement among them to adopt and follow an industry sales plan and they resorted to the conscious parallelism argument.

Pennell, J. stated at p. 499:

> "Conscious parallelism, if I understand the evidence aright [sic], might be defined as pricing that emerges out of an oligopolistic market setting without communication or agreement among the sellers. The crux of the theory of conscious parallelism is briefly that the oligopolists are interdependent in their pricing: they base their pricing decisions in part on anticipated reactions to them. Put differently, the oligopolist is behaving in exactly the same way as is a rational seller in a competitively structured market; he is simply taking into account the reactions of his rivals to any price cut or increase which he has to take into account because of the situation in which he finds himself. The accused assert that proof of conscious parallelism business behaviour does not constitute a *Combines Investigation Act* offence. The Crown, on the other hand, as confidently asserts that conscious parallelism has not yet read conspiracy out of the *Combines Investigation Act*. To concede both propositions is not to resolve this case. The question which requires decision is whether there was an agreement or arrangement in violation of the Act."

The judge found that large lamps were homogeneous products and that there was an oligopoly; a highly-concentrated industry where a few manufacturers make up the bulk of sales. Prior to 1959, the industry had gone through a period of intense price cutting. CGE's first attempt at price and market leadership came in 1959 when they published a Large Lamp Sales Plan and Price List. There was follow-the-leader behaviour. In 1961, CGE announced a revised sales plan. Again, there was disciplined follow-the-leader behaviour.

The Crown asserted that the whole of the evidence warranted the inference that there was a tacit understanding that if CGE put out a plan, it would be followed. Each of the accused had similar plans and price lists that went to market during the alleged conspiratorial period through basically the same lines of distribution. The introduction of the plans, it was alleged, resulted from a coordination of acts by the accused to attain the desired industry distribution scheme and pricing structure.

The accused argued conscious parallelism and that conscious parallelism was not sufficient as a matter of law to support a charge of conspiracy. Reference was made to *Canada Cement LaFarge* (1973), 12 C.P.R. (2d) 12. It was said that Camblin, J. there held that conscious parallelism without collusion was not an offence. There was further reliance upon the earlier quoted speech of Mr. Henry.

In *Canadian General Electric* (1974) 17 C.C.C. (2d) 433, Pennell, J. states at p. 517:

> "I agree that competition for the purposes of s.32 of the Act must be viewed in light of the market structure of the particular business. But I am of opinion that the theory of oligopoly pricing is irrelevant to the determination of whether or not the accused have offended the proscription on them under the conspiracy section of the Act. As stated in *R. v. J.W. Mills & Son Ltd. et al.* (1968), 56 C.P.R. 1 at p.46,...:
>
> > 'The fact that under the theory of oligopoly prices would have been the same in the long run is irrelevant. No persons are entitled to engage in

> > anti-competitive trade practices or policies because this result may obtain in any event if all things are equal.'
>
> I do not say that proof of parallel business behaviour conclusively establishes an agreement contrary to the provisions of the *Combines Investigation Act*."

Pennell, J. went on to consider the evidence which satisfied him that the parallel conduct of the accused came about as a result of an agreement or arrangement. Again, the evidence was convincing. The evidence included a letter from CGE to Westinghouse which referred to a mistake made by one of their agents in specifying a 5% discount, whereas other distributors had tendered a 2% discount. When the error was made, an attempt was made to withdraw the tender and permission was refused. The CGE letter explained that it was CGE's policy to follow their sales plan at all times and that the gross profit on the particular transaction would be donated to charity. This letter was returned by the addressee stating that he did not know why it had been sent to him. The court concluded that this was not the conduct of a competitor but of a sales manager who believed that the accused were united in agreement, express or implied, to act together and pursue a common purpose. There were various other instances of impugned communication.

The conclusions arrived at by Pennell, J. were that the published price lists of CGE became the signal for what CGE deemed to be a fair price. Simultaneous pricing behaviour was a product of a deliberate market strategy to publish price information far in advance to allow the followers to respond without a time lag. He found the continuing communication among the accused significant. He was not able to reconcile the substantial unanimity of action taken by the accused with conscious parallelism.

6.6 Cominco

In *R. v. Cominco Ltd. et al.* [1980] 2 W.W.R. 693, the fertilizer industry in Western Canada was found to be an oligopoly, which was referred to as a situation existing where there are only a few producers or sellers of a standardized or homogenous product. Dr. Bradley, an economist and a Crown witness, agreed that most manufacturing industries in Canada are oligopolistic. The Crown submitted that the evidence revealed that retail prices of various formulations of fertilizer manufactured by the accused were, if not identical, similar to the other accused. It was alleged that the accused set up a series of enabling factors directed at a system of coordinated prices. These factors included: zone pricing, standardization of terms of sale, refusal to sell to buying groups, and various sales and exchanges of fertilizer among the accused. The Crown alleged that the only reasonable inference which could be drawn from all the evidence was that the identity or close similarity of prices could only have been achieved by agreement.

Brennan, J. did not accept the Crown's position. He concluded at p. 716:

> "The very documents upon which the Crown relies so heavily, disclose that, throughout the period covered by the indictment, a highly competitive climate existed in the fertilizer industry. They disclose that each of the accused kept constant surveillance as to what was going on in the industry in which they were involved. They each had very extensive sources for gathering information as to moves and actions taken by their competitors, not the least of which were customers or potential customers who shopped around and thus obtained information which they then passed on among competitors in the hope of getting a better deal.
>
> These documents also disclose that the accused were quick to react to information they received with respect to pricing or other moves by their competitors in order to meet the effect of the competition which they faced as a result of such pricing or other move. There was a constant effort by the accused to take away business from their competitors by attempting, and frequently succeeding, in having a competitor's distributor or dealer become their distributor or dealer.
>
> ...
>
> It is my view that an inference which is equally as reasonable as that suggested by the Crown is that the identity or similarity of the apparent retail prices came about as a result of the highly competitive climate which existed in the fertilizer industry during the period in question."

An analysis of the foregoing cases reveals that conscious parallelism cannot be equated to collusion. Further evidence of the lack of independent decision-making will be required. The results of the two situations may be similar in appearnce. However, an examination of all of the evidence must be conducted to determine whether the result was achieved through an agreement. An informative analysis of evidentiary factors which could be of significance in determining guilt or innocence under the conspiracy section of the Act is found in Webber, "Oligopoly and the Combines Investigation Act," (1981-82), 6 *Canadian Business Law Journal* 453.

7.0 CONCLUSION

The number and complexity of conspiracy cases under the *Competition Act* and its predecessors have generated a significant volume of jurisprudence on evidentiary issues. Several important statutory enactments have altered the rules of evidence, in some cases dramatically. These enactments have occurred largely to assist the Crown in proving conspiracies, which by their nature are difficult to prove.

Rules of evidence have developed down through the ages with the aim of endeavouring to ensure that criminal convictions only occur when based on reliable and credible evidence and only after the accused has been afforded a full opportunity to test the evidence through cross-examination. The right of the accused to a fair trial must not succumb to the exigencies of ensuring the admission of evidence which is difficult to prove. The appropriate balance of these competing interests must be carefully guarded.

The Canadian *Charter of Rights and Freedoms* has had a significant impact on Canadian competition legislation. The *Charter* will no doubt be invoked regularly in the years to come as more post-Charter cases work their way through the courts. The *Charter* also makes it highly likely that during the coming decades the development of the law relating to evidence in competition cases will be as eventful and provocative as in the first 100 years.

Chapter 8

GLOBALIZATION AND THE CONSPIRACY PROVISIONS

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The purpose of this paper is to review the application of the conspiracy provisions to export agreements and to assess whether the current export agreement defence is appropriate in light of the globalization of economic activity. The approach taken is to look at the evolution of this defence in Canada's legislation on agreements in restraint of trade.

1.0 BACKGROUND

A search for the origins of section 45.(1) of the *Competition Act* takes us back 100 years to the enactment, in 1889, of section 498 of the *Criminal Code*. In substance, S.498 declared to be criminal any conspiracy to unlawfully and unduly lessen competition in the supply of an article. In 1899, the adverb "unduly" was deleted. In 1900, "unduly" was restored and the word "unlawfully" was removed.[1]

In time, S.498 of the *Criminal Code* became S.520 and later S.411. In 1960, S.411 was repealed and a new S.32.(1) of the *Combines Investigation Act* was enacted incorporating S.411.[2]

In 1976, S.32.(1) was amended to extend its provisions to services.[3] In 1986, the *Combines Investigation Act* was substantially amended and was renamed the *Competition Act*.[4] In December of 1988, on the coming into force of the Revised Statutes of Canada, 1985, the section numbers of the *Competition Act* were changed and S.32.(1) became S.45.(1).

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[1] A chronology can be found in Appendix A of Stanbury's paper in Part 2 of this volume.

[2] 1960, c. 45

[3] 1974-75-76, c. 76

[4] 1986, c. 26

2.0 THE 1960 AMENDMENTS

The 1960 amendments were proposed by Bill C-58 which, when enacted, transferred S.411 of the *Criminal Code* to new S.32.(1) of the *Combines Investigation Act*. Additional provisions were enacted at the same time under subsections (2) to (5) which had the effect of amending new S.32.(1). These amendments dealt with agreements relating to certain business practices and agreements relating to exports. The amendments took the form of instructing a court to not convict an accused of being party to an illegal conspiracy, if the agreement related only to one or more of the defined business practices or to the export of articles unless, in either case, accompanied by certain anti-competitive or harmful effects. The export provision reads as follows:

> 32...
>
> (4) Subject to subsection (5), in a prosecution under subsection (1) the court shall not convict the accused if the conspiracy, combination, agreement or arrangement relates only to the export of articles from Canada.
>
> (5) Subsection (4) does not apply if the conspiracy, combination, agreement or arrangement
>
> (a) has resulted or is likely to result in a reduction or limitation of the volume of exports of an article;
>
> (b) has restrained or injured or is likely to restrain or injure the export business of any domestic competitor who is not a party to the conspiracy, combination, agreement or arrangement;
>
> (c) has restricted or is likely to restrict any person from entering into the business of exporting articles from Canada; or
>
> (d) has lessened or is likely to lessen competition unduly in relation to an article in the domestic market.

Curiously, the explanatory notes to Bill C-58, opposite the proposed ss.(2) to (5) of S.32., did not deal with the new export defence. The notes said:

> Subsection (1) of the new section 32, as explained in the notes opposite clause 1 of this Bill, incorporates section 411 of the *Criminal Code*, which has been in effect since 1889, and without substantial modification since 1900, and is the law under which existing jurisprudence in relation to combinations has been established.
>
> Subsection (2) of the new section 32 makes it clear that certain practices that are not detrimental to the public interest, but should rather confer benefits on the economy, may be followed provided that they are not accompanied by harmful effects.

> The purpose of subsection (3) is to make it clear that, notwithstanding that certain practices come within subsection (2), the accused cannot avail himself of that subsection if these practices are accompanied by effects that are detrimental to the public interest.

It is a principle of criminal law that it should have no extra-territorial effect. Applying this principle to the conspiracy offence under the *Competition Act* and to the predecessor provisions, one would expect that they should be read so as to reach and punish only those conspiracies which would have an undue effect on the public interest in protecting competition in Canada.

In the first and leading decision of the Supreme Court of Canada with respect to the conspiracy offence, *Weidman v. Shragge*, Duff, J. said that "The particular sub-section with which we are concerned was plainly intended to protect the specific public interest in free competition."[5]

In the early leading case of *The King v. Elliott*[6] (cited with approval by Anglin, J. in *Weidman v. Shragge*, at pp.42, 43 of the report) the Ontario Court of Appeal affirmed the conviction of the accused under S.520 (d) of the *Criminal Code* for having conspired to lessen competition unduly in the supply of coal in the Province of Ontario. The accused was the President of "The Ontario Coal Association" which, it was found, had through its coal dealer members established a monopoly in the supply of coal in Ontario. The coal was mined in the U.S. and imported into Ontario through Buffalo, New York. A jurisdictional argument was raised that the Court had no jurisdiction since the coal originated outside Canada. Osler, J.A., who delivered the unanimous decision of the Court, dealt with this argument as follows:

> It was contended that the combination was not within the statute because it affected only the supply at the source in a foreign country, but that is not its whole scope or limit by any means. It strikes at competition in this country in the supply and sale of coal here, and it is immaterial that it affects the conduct of the foreign vendor also, when that has reference to and affects persons resident here: *State v. Lancashire Fire Ins. Co.* (1899), 66 Ark. 466, 477; and see *The People of the State of New York v. Sheldon* (1893), 139 N.Y. 251; 20 Am. & Eng. Ency., 2nd ed., 854, 855.[7]

This reasoning would appear to support the proposition that, prior to the 1960 amendments, the provisions of S.411 of the *Criminal Code* should not be interpreted so as to confer on Canadian courts jurisdiction to deal with an agreement, made in Canada, to lessen competition unduly in respect of the supply of an article in or to a foreign country.

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[5] (1912) XLVI S.C.R., 1 at p. 36.

[6] (1905) 9 C.C.C., 505.

[7] (1905) 9 C.C.C. 505 at p. 521.

The odd effect of the 1960 amendments introducing the export defence at ss.(4) is that the scope of the conspiracy offence has been extended to include an agreement to prevent or lessen competition unduly in relation only to exports from Canada in circumstances where the export defence does not apply because of the provisions of ss.(5).

Apparently there is only one decision dealing with the export defence, *R. v. Manigo Inc. et al.*,[8] a recent decision of the Quebec Superior Court. The eleven accused had been charged with conspiracy to prevent or lessen unduly competition in the supply of Gaspé cured salted cod to the Italian market contrary to S.32.(1)(c) of the *Competition Act*. The prosecution was taken under the 1960 amendments.

The evidence was that the Gaspé cod fish processors had established a consortium for the purpose of exporting Gaspé cured salted cod to a single importer in Italy. One of the fish processors, in breach of its agreement with the consortium, agreed to supply Gaspé cured salted cod to an independent exporter for supply to another Italian importer. The consortium brought civil proceedings to enjoin the supply of Gaspé cured salted cod to the independent exporter. In the criminal prosecution which ensued, the Court held that the Gaspé cod fish processors had entered into an agreement to lessen competition unduly in the Italian market;[9] that, under the terms of that agreement, the independent exporter was unable to export Gaspé cured salted cod to Italy with the result that the agreement fell within the provisions of paragraphs (b) and (c) of ss.(5) with the consequence that the defence under S.32.(4) did not apply. Accordingly, the accused were convicted and each was fined $1000 and made subject to a prohibition order.[10]

3.0 THE 1976 AMENDMENTS

The 1976 amendments extended the provisions of S.32 to cover "products" which include "services" as well as "articles." At the same time S.32.(1.1) (now S.45.(2)) was introduced to ease the burden of the prosecution to make it clear that it was not necessary to prove that a conspiracy would, if carried into effect, virtually eliminate competition or that such was the object of the parties.

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[8] Dated January 14, 1988 (unreported).

[9] Although there was no consideration given to the relevant product market for the purpose of competition analysis, the Court appears to have considered it to be Gaspé cured salted cod and presumably the consortium included all of the Gaspé cod fish processors.

[10] See Director of Investigation and Research, *Annual Report* for the year ended March 31, 1988 (Ottawa: Minister of Supply and Services Canada, 1988), p. 17.

Subsections 32.1(1) and (2) (now ss.46(1)(2)) were introduced dealing with the implementation, in Canada, of restrictive agreements entered into outside the country.

The new bid-rigging offence was enacted at S.32.2 (now S.47). Under these provisions an agreement whereby a person, in response to an invitation to bid, agrees to not submit a bid or to submit a joint bid, is illegal if that agreement were not made known to the person calling for bids.

It is not unusual that bids are sought in foreign countries. However, unlike the general conspiracy offence, there is no provision excluding bids made abroad from the reach of the law. Would a court infer from this that the bid-rigging offence applies to agreements made in Canada in response to foreign calls for bids or would a court conclude that the provision had no extra-territorial application?

The lack of a clear legislative direction imposing territorial restraints on the bid-rigging offence is most unsatisfactory.

4.0 THE 1986 AMENDMENTS[11]

4.1 Evidence of Conspiracy

In 1986, S.45. was again amended by adding at ss.(2.1) and (2.2) two further provisions designed to ease the burden of the prosecution. The first of these provided that a court may infer the existence of a conspiracy from circumstantial evidence with or without direct evidence of communication among the conspirators. This seems to go no further than restating the existing law. The second amendment required that the prosecution prove that the parties intended to and did enter into the impugned agreement but not that they intended that the agreement have an effect set out in subsection (1).

This amendment would appear to introduce the law as formulated by Houlden, J.A. in the Ontario Court of Appeal in *Regina v. Anthes Business Forms Ltd.*[12]

A brief comment is required since the amendment may well affect the scope of the export defence. In many of the leading cases there was little or no direct evidence of an agreement. Therefore, the prosecution sought to prove an illegal agreement from evidence of the course of conduct of the accused. In *Aetna Insurance Co. v. The Queen*, Ritchie, J., speaking for the majority, said:

> The fact that an agreement existed to prevent or lessen competition in the price of insurance does not of itself constitute an offence under the section; the illegal character of the agreement lies in the fact that the prevention or lessening is undue and it appears to me that the best if not the only way in which to determine this is

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[11] The references which follow are to the revised numbering effective December 12, 1988.

[12] (1975) 26 C.C.C. (2d) 349.

> by considering whether competition would be unduly prevented or lessened if the design evidenced by the agreement were carried into effect. In my view, it is only by assessing what the result would be if the agreement were implemented that the elusive quality of undueness can be measured, and it was for this reason that the learned trial Judge in the present case heard evidence as to the effect of the plan on free competition in the insurance business.[13]

He also approved of the following passage in the decision of the trial judge:

> This review of the various statements on the meaning of "unduly" as it relates to the offence of lessening competition brings me to these conclusions. An agreement to prevent or lessen competition alone is not an offence. What is criminal is an agreement that is intended to lessen competition improperly, inordinately, excessively, oppressively or one intended to have the effect of virtually relieving the conspirators from the influence of free competition. There is no requirement for the Crown to prove the existence of a monopoly and it is a question of fact as to whether the agreement reaches the point of intending to lessen competition unduly and therefore becomes a criminal conspiracy.[14]

In other words, the illegal character of an agreement to prevent or lessen competition lies in the design evidenced by the agreement to lessen competition and the question is whether competition would be unduly prevented or lessened if that design were carried into effect.

This approach appears to have been in the mind of Pigeon, J., speaking for the majority, in *Atlantic Sugar Refineries Co. Ltd. v. A.G. Canada*,[15] where the salient facts were these.

Redpath had initiated a price war to gain market share. Although it initially succeeded, the war proved costly, was lost and its market share then declined. Consequently, Redpath adopted a strategy designed to restore historic market shares in the hope that it would be understood and followed by its competitors. The plan basically succeeded.

The trial judge concluded that there was evidence of a "tacit" agreement to revert to and maintain historic market shares but that it had not been shown that this agreement was arrived at with the intention of unduly lessening competition. Pigeon, J. decided that the "tacit" agreement did not amount to an agreement to lessen competition unduly. Although he concluded that the "tacit" agreement lacked the element of communication to amount to an agreement or conspiracy, he also concluded that the "tacit" agreement did not suppress competition. Later, after quoting the passage from the trial judgment cited by Ritchie, J. in *Aetna*, Pigeon, J. concluded that it was not proved that the accused had entered into an agreement that was intended to lessen competition unduly, that is to say, intended to lessen competition to the point that the Court, as a question of law, would consider undue.

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[13] (1977) 30 C.P.R. (2d) 193 at p. 204.

[14] *Ibid.* at p. 205.

[15] (1980) 115 D.L.R. (3d) 21.

By contrast, under the 1986 amendments, the relevant element of intent is the intention to enter into an agreement and the focus is on the effect of the agreement on competition.

4.2 Exports

Subsection (5) of S.45 remained unchanged but subsection (6) was replaced with the following:

> (6) Subsection (5) does not apply if the conspiracy, combination, agreement or arrangement
>
> (a) has resulted in or is likely to result in a reduction or limitation of the real value of exports of a product;
>
> (b) has restricted or is likely to restrict any person from entering into or expanding the business of exporting products from Canada; or
>
> (c) has prevented or lessened or is likely to prevent or lessen competition unduly in the supply of services facilitating the export of products from Canada.
>
> (d) [Repealed, 1986, c. 26,S.30]

Paragraph (a) provides that the agreement must not affect the real value instead of the volume of exports. Paragraph (b) has been enlarged to include expanding as well as entering into a business and therefore covers most of the ground that had been covered by the previous paragraphs (b) and (c). Paragraph (c) is new and, as noted, paragraph (d) was repealed. That paragraph had provided that subsection (5) does not apply if the export agreement: "(d) has lessened or is likely to lessen competition unduly in relation to a product in the domestic market."

While ss.(5) of S.45 was not changed, the meaning of the words "agreement relates only to the export of products" may have been affected by the amendment introducing ss.(2.2). If proof of the element of intent is made out by proof of the intent to enter into an agreement, whether an agreement "relates only" to exports may be determinable by reference to its effect rather than by reference to the object or design which the parties had in their mind. If the parties intended that the agreement relate only to exports but it had an ancillary effect on the domestic market, even if unintended, could it be said that the agreement related only to exports?

Also relevant to this analysis is the fact that prior to the 1986 amendments, the defence under ss.(5) would be lost if the "agreement which relates only" to exports "has lessened or is likely to lessen competition unduly in relation to a product in the domestic market." Impliedly, an export agreement could qualify as being defensible if competition in the domestic market were lessened but not to the point of being unduly lessened.

Arguably, the export defence has been narrowed, rather than broadened, by the combined effect of the enactment of ss.(2.2) and the repeal of paragraph (d) of ss.(6). On this view, Canadian exporters, who compete in the domestic market, and who dominate a foreign market, might find themselves convicted of a conspiracy to lessen competition unduly in relation to the foreign market, only because the defence was lost for the reason that the agreement had some effect in Canada even if unintended, and even if that effect did not amount to an undue lessening of competition!

4.3 Public Policy

The "News Release" which accompanied the introduction of Bill C-91 (which proposed the above amendments including the repeal of paragraph (d) of ss.(6)) said:

> We are also broadening the export exemption under the conspiracy provisions. This should enhance Canada's export trade by facilitating the formation of export consortia.

Evidently it was thought that by repealing paragraph (d) of ss.(6), an agreement designed to deal with exports and which had an unintentional spillover effect in the Canadian market would not lose its defensible position under ss.(5). Regretfully, a strong argument may be mounted the other way.

That such a result was not intended seems evident from other provisions of the *Competition Act* favouring exports, namely:

> (a) S.1.1, the purpose clause;
>
> (b) S.96, the overriding efficiency defence in merger analysis involving a consideration of whether the merger will result in a significant increase in the real value of exports; and
>
> (c) S.85, specialization agreements which also involve the consideration of whether they will result in a significant increase in the real value of exports.

5.0 THE AMERICAN SOLUTION

The U.S. *Export Trading Company Act of 1982* authorizes the establishment of export trading companies and provides a mechanism whereby, on application to the Secretary of Commerce, with a copy to the Attorney General, a certificate of review may be issued in regard to a proposed export activity, the effect of which is that no criminal or civil action may be brought under the antitrust laws with respect to conduct undertaken. At the same time, substantial amendments have been made to the *Sherman Act* and to the *Federal Trade Commission Act* exempting foreign trade unless such conduct has a direct, substantial, and reasonably foreseeable effect on domestic or import trade or on the export trade of a competitor.

As a consequence, an export consortium is free to approach the Secretary of Commerce for a certificate of review with attendant exemptions or, if it chooses, to take its chances that the export arrangement would not be in violation of the antitrust laws as amended. Provision is also made for a second review by the Secretary of Commerce, if a certificate is not issued, and finally for a judicial review of his decision, if negative.

There is no requirement that the export arrangement must not limit the value (or volume) of exports; on the contrary, the effect of the consortium on exports is left to the good judgment of the businessmen, subject to the provisos noted that the arrangement must not have the defined consequences in the domestic market or on an exporting competitor. The words "direct, substantial and reasonably foreseeable effect" should be contrasted with what we now find (or do not find) at S.45 of the *Competition Act*. They deal clearly with the spillover concerns inherent in export arrangements.

6.0 GLOBALIZATION

It would seem only desirable, as a matter of public policy, to encourage export consortia provided that there be no undesirable effect in the domestic market or on the export trade of a competitor. International trade involves a good deal of competition between nations. It could take the form of consortia organized under American law, a Finnish State Trading Company, an OPEC, a Wheat Board or a National Energy Board.

Obviously, Canadian corporations must be mindful of and be prepared to obey the antitrust laws of the countries in which they do business. What is permitted by the exporter's domestic law may be prohibited by the laws of the importer. However, the absence of a clear exemption under Canada's antitrust laws is most troublesome.

In a Canadian context, the title of this paper might have been, "The Impact of the Conspiracy Provisions on Globalization." Canadian exporters should not be put in the position of having to defend themselves against a criminal charge by proving, on a balance of probabilities at the end of a lengthy trial, that the impugned agreement related only to exports. Nor should their fate depend on whether, in the view of the court, the real value of exports may have been greater or less in the absence of an agreement.

Canada needs clear exempting provisions such as those found under U.S. law.

Chapter 9

MERGER POLICY IN SMALL VS LARGE ECONOMIES

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1.0 INTRODUCTION

Studies on mergers indicate that a wide variety of motives may underlie the corporate decision to increase size via acquisition of an existing business as against undertaking internal expansion and new investment (see Ravenscraft and Scherer, 1987; Steiner, 1975; Reuber and Roseman, 1969). In the case of horizontal mergers, antitrust authorities are especially interested in two possible motives: the increase in market power and/or economic efficiency that may stem from the merger. Distinguishing the extent to which a horizontal acquisition will enable the merging firms to exercise market power and earn supra-competitive profits and/or exploit efficiencies that would otherwise not be realized, have been recognized as highly complex and controversial subjects in industrial organization economics. The issues however have been discussed primarily, if not exclusively, in the context of "large" rather than "small" economies. As a starting point, in large economies such as that of the United States, there tend to be a greater number of market participants/stakeholders in a merger - be they competitors, suppliers or customers. Many of the analytical difficulties confronted by economists in dealing with small numbers of market participants and oligoplistic interdependence are less likely to occur in the merger review process than in a small economy such as that of Canada's. Moreover, an erroneous assessment of the economic effects of a merger by antitrust authorities is likely to have a relatively greater impact in small than in large economies.

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*. This paper was prepared when the author was Director, Economics and International Affairs Branch, Bureau of Competition Policy, Consumer and Corporate Affairs Canada, Ottawa-Hull. Prior to that he was Senior Policy Advisor, Merger Branch. The author is grateful for comments and helpful suggestions on an earlier draft provided by Gary Hewitt. The views expressed in this paper do not necessarily reflect those of the Bureau of Competition Policy.

This paper discusses some of the complexities of inter-firm competitive dynamics which need to be considered in the particular context of merger policy in small economies. Section 2 which follows describes the nature of the market structure-oligopoly problem in Canada. Section 3 discusses the efficiency aspects of mergers. Section 4 presents the conclusions.

2.0 SMALL MARKETS AND COMPETITIVE DYNAMICS

A broad definition of competition implies individual striving by various sellers for the patronage of buyers in a market. The determination of the extent to which competition prevails in any given market necessitates an examination of those factors which enable firms to directly influence or control market outcomes - particularly relating to prices, output, profit levels, product attributes and innovation (see Kaysen and Turner, 1959; Scherer, 1980). The term "market power" generally refers to the ability of a firm (or group of firms) to raise and maintain price above the competitive level, thereby earning supra-normal profits without losing significant sales to existing or potential rivals.

Competition in a market is most readily evident if there happens to be extensive rivalry in both price and non-price terms among firms with consequent changes over time in their relative ranks, market shares and profits, after allowing for cyclical variations. While economic theory suggests that competition is more likely to prevail the larger the number of firms in the market, this relationship has been recognized as being not necessarily monotonic. Competitive rivalry may exist among as few as two firms in a market and in the absence of barriers to entry, the exercise of market power by even a single firm monopolist may be severely constrained by potential entrants. Also, stable price, market share and profit relationships in and of themselves may not reflect arrangements restrictive of competition. The critical issue that confronts economists in antitrust agencies is how an existing or prospective anti-competitive market structure can be recognized. Aside from the fact that there is no consensus on this issue amongst the economist profession, the structural characteristics of small economies such as Canada's pose further difficulties.

Most markets in Canada tend to be oligopolies. For example, 92% of the five-digit standard classification commodities in manufacturing (e.g. four-door passenger sedans, canned soup ... etc.) are produced in industries where the leading four (or fewer) firms account for 60% or more of total sales. In fact 82% of these commodities are produced by four or fewer firms which account for 80% or more of total industry sales (see Khemani, 1986). Firms in such industries or markets are likely to be inherently interdependent in their pricing and output policies. From a competition policy perspective, a distinction needs to be made between business practices of firms that have been arrived at through price or market share agreements and those that reflect conscious parallel behaviour amongst firms in oligopolistic markets. Although difficulties encountered in making this distinction are confronted in varying degrees by all antitrust authorities, in small economies such as that of Canada's, an additional complication tends to arise. That is, market structures may have evolved such that not all the available economies of scope and scale have been exploited. In other words, the question is raised as to whether or not the relative size and number of firms in oligopolistic industries in small markets is consistent with the pursuit of economic efficiency.

The traditional industrial organization paradigm in Canada (see Eastman-Stykolt, 1967) postulates that Canada's small and geographically segmented markets often lead to high levels of market concentration. Although Canadian companies tend to be large relative to the domestic market, many firms are still too small to achieve efficient scale of production. This implies that the observed levels of concentration would perhaps be even higher if firms were able to exploit fully all the potential economies of scale. Consequently, Canadian industries may be "overcrowded" with suboptimal plants having short production runs and duplicate or multiple product lines/outputs, thereby incurring excessive costs of production.

Critics of this paradigm (see Muller, 1982) pose the question why, in at least industries with homogenous or undifferentiated products, one of the sub-optimally sized firms does not build an optimum sized plant and acquire a larger share of the market? Such a firm would have an advantage by being able to supply the market at substantially lower costs than its rivals. The answer may lie, in part, in the fact that recognition of mutual oligopolistic interdependence prevents firms from adopting such a business strategy. It obviously takes less time for rival firms to react by charging lower prices than it does to build and operate a plant of optimum size. The advantage gained by the "first mover" firm may not be sustainable over time and may initiate a costly price war with adverse effects on its own, as well as industry profits before the efficient scale plant can even be brought into production.

Notwithstanding the questions raised by Muller (1982) on the theoretical underpinnings of the Eastman-Stykolt paradigm, the model has received analytical and empirical support from various studies. Caves *et al*. (1980) have persuasively argued that the paradigm is best appreciated in the context of product differentiated oligopolies. Baldwin and Gorecki (1983) found that the combination of high tariffs and high concentration negatively influences plant scale. Khemani and Shapiro (1986) discovered that the combined effects of high concentration and tariffs act as barriers to entry possibly encouraging oligopolistic coordination among incumbent firms because of the absence of significant foreign competitors.

In an earlier study on the determinants of industrial plant sizes in six nations, Scherer (1973) noted that in addition to market size and transportation costs, potential or actual oligopolistic rivalry imposed constraints on individual plants achieving minimum efficient scale (MES) of operation. Entry at MES could be viewed as a competitive attack on the market shares of established firms producing uncertainty and perhaps instigating a (unprofitable) price war. An alternative strategy may therefore be to merge and rationalize production but this in and of itself may not lead to minimizing uncertainty and the costs of market expansion for the firm particularly if the final oligopolistic solution leads to one plant undertaking production at the MES level and high costs are incurred in converting the remaining plants to some other economic activity or have to be kept idle.

An analysis of 20 comparable industries by Bloch (1974) indicates that relative to the U.S., prices are greatest when Canadian industries are both concentrated and protected by high tariffs. This combination of high concentration and high tariffs also contributed to high costs in Canadian industries, which were attributed to the lack of competition. Where concentration was high in Canada relative to the U.S., profits were also high irrespective of the level of tariffs. These differences did not appear to exist in industries with low concentration regardless of the level of tariff protection.

Although some of these studies may be viewed as out-dated, particularly in light of the Canada-U.S. Free Trade Agreement of 1989, the possibility that inefficient plant size or insufficiently long production runs are endemic to Canadian industry cannot be ignored when administering competition policy. What is implied for merger policy, in particular, is that existing market structures in Canada may be such that supra-competitive prices could prevail because of high costs or oligopolistic coordination or both. If current prices reflect oligopolistic coordination, competition policy authorities run the risk of falling into what has been referred to in the U.S. as the "cellophane trap"[1] in approving a proposed merger. That is, the existing prices charged by the firms may already reflect the exercise of market power and, a merger may therefore not make it feasible to increase prices further under prevailing demand conditions. Other things being equal, while the merger in such situations may not make matters worse in terms of price, it may nevertheless entrench existing market structure. In such situations the existing or projected post-merger prices ought to be compared with those that would likely prevail under more competitive market structures rather than those being charged pre-merger. One such method may be to compare appropriately adjusted Canada-U.S. prices for like products and analyze the differences in terms of the nature of inter-firm competitive dynamics. This approach is not without practical difficulties, however, and does not entirely circumvent the oligopolistic interdependency problem in Canada.

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[1] In *U.S. vs. E.J. DuPont de Nemours and Co.*, 351 U.S. 377 (1956) U.S. the Supreme Court found there were many substitutes for cellophane that customers could and did use. DuPont had elevated its prices and realized supra-competitive profits on its technically superior product thus attracting numerous imperfect and less versatile substitutes. The problem as various commentators have pointed out, a profit maximizing monopolist would raise its price until some (but not most) of its customers have been driven to the use of substitutes. The presence of substitutes is not necessarily an indication of the absence of market power. Its the extent and significance of the impact of these substitutes that matters. Broadly speaking, all products compete for consumer dollars but in defining relevant markets, only those that are in direct competition across a product characteristic and geographic space matter. See American Bar Association (1986), White (1987) and citations therein for further details on the "cellophane trap" and market definitional issues.

In contrast, if existing prices reflect high costs, an efficiency-generating merger may have a price lowering or constraining effect in absence of collusion or strategic rivalry of the type referred to earlier. However, analysis of such situations poses its own difficulties as well. A horizontal merger by definition reduces the number of competitors. While the merger may itself generate efficiencies, the reduction in the number of firms may only further increase the degree of oligopolistic interdependence. The consequences may be such that even if the incentives to reduce output and raise price are not present, in the long run the gains in efficiency may nevertheless be eroded, at least in part, due to organizational "slack" and other "x-inefficiencies." The oligopoly-monopoly problem in economics is not only concerned with prices but with costs as well. Inter-firm competition is an important stimulus to cost minimization (as is the market for corporate control which, as is discussed further below is somewhat limited in Canada). At which point competitive rivalry ceases and oligopolistic interdependence emerges remains undetermined in economics.

Thus far, the discussion has referred to "horizontal" interdependence among oligopolistic firms operating in a given market. However, in small economies the 'vertical' interdependencies between buyers and sellers of intermediate products also tends to be accentuated. Many of the merger cases reviewed in Canada under the *Competition Act* of 1986 not only confirm the types of oligopoly-cost efficiency issues discussed above, but also that high levels of seller concentration in intermediate product markets are often combined with high levels of buyer concentration.

The bilateral oligopoly (monopoly) - oligopsony (monopsony) problem has been described in industrial organization economics as being "... indeterminate with a vengeance" (Scherer, 1980, p. 299). Nonetheless, a number of interesting empirical facts and institutional solutions seem to emerge in the Canadian context. Scherer *et al*. (1975, p. 134) in their examination of plant scale and multiplant operations state that:

> One reason clearly apparent in Canada was that consumers, and particularly industrial buyers, exhibited a strong preference for having at least two alternative supply sources, even if it meant fragmenting what would otherwise be a natural monopoly and causing unit costs (although not necessarily prices) to be higher. Industrial buyers of paints, bottles, cement, steel, and batteries evidently value both

> the security against total interruption of supplies and the bargaining power conferred by being able to play one producer off against the other.

This fact, which has received further empirical support in some recent Canadian merger cases, lends support to the cross-section results which Kwoka (1979) and Kwoka and Ravenscraft (1986) report on the price and profit constraining influence exercised by the third or fourth largest firms in concentrated industries. The extent to which recognition is given to this finding implies that competition authorities may at times be confronted with a difficult choice of having to place greater emphasis on the number of competing firms than on the efficiencies that would otherwise be generated by a merger.

In some instances, the magnitude of the cost penalties of sub-optimal production may be great enough to endanger the commercial viability of both upstream producers and downstream users of intermediate products. Consequently firms may be willing to forego the advantages of multiple sources of supply and purchases. In such cases 'credible commitments' may be undertaken in support of alliances to promote exchange which may be designed to exploit efficiencies rather than to limit competition. Examination of some recent energy product related mergers in Canada reveal that contractual arrangements are often put in place in order to safeguard against credible threats or post-contractual opportunistic behaviour by one of the parties.[2] These arrangements are aimed at avoiding the cost penalties that would be incurred if production were to be disrupted. Moreover, bilateral monopoly pricing solutions are arrived at by specifying the terms of exchange in reference to a more competitive U.S. market price benchmark, e.g. the U.S. Gulf Coast over which neither party can exert any influence. And, since the final product being sold is often in markets influenced by North American or global competition, the opportunities for earning monopoly rents by the upstream supplier of intermediate products or adopting anticompetitive pricing strategies are both severely constrained if not precluded.

Notwithstanding that such alliances or contractual arrangements may be aimed at facilitating exchange and exploiting efficiencies, the specificity of required investment, the gestation and economic life of the assets, the scale of output, the significant cost penalties of disrupted production and paucity of alternative suppliers or purchasers also appear to give rise to longer term contractual arrangements in Canada than those evident in the United States. Such long term contracts have the effect of increasing the height of already high barriers to entry that new firms confront in the form of sunk costs and cost penalties of sub-optimal scale of operation.[3]

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[2] See Klein *et al.* (1978) for discussion on competitive contractual process and opportunistic behaviour.

Various suggestions have been put forward in the economic literature regarding the types of information which may be used, prima facie, to predict the likely competitive effects of a merger. One such suggestion relates to the reactions of other firms: any merger that is opposed by the merging firms' customers and suppliers but supported by their competitors is viewed as likely to lead to higher prices. However, the dependency of customers and suppliers on one or both of the merging firms may tend to mute such complaints if the increased cost penalties to customers or suppliers of an already sub-optimal operation are significant in the event of possible retaliatory action by the merging parties. Moreover, the complaints of rivals cannot be ignored if the proposed merger is strategically aimed at altering the non-cooperative behaviour of equal sized firms by increasing the size inequality among a reduced number of firms so as to give rise to dominant firm pricing behaviour.[4] While it may be argued that rival firms are equally in a position to counter bid for the target firm to prevent such a possible outcome, experience in Canada shows that most acquisitions are "negotiated or friendly takeovers" of closely-held firms. Indeed, the majority of the stock exchange listed companies tend to be closely held and the market for corporate control in the form of tender offers is quite limited. This economic reality also severely restricts the use of stock price data as a complementary approach towards distinguishing the efficiency or price effects of a merger. According to this method, if the merger is likely to lead to collusion or dominant firm behaviour, the share prices of rivals will tend to rise as they too will benefit from higher post-merger prices. In contrast, the share prices of rivals will

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3. Oligopolistic interdependence may however also give rise to various 'facilitating' devices and pricing contracts with "most favoured nation or customer" type clauses which can result in anti-competitive consequences. See Salop (1986) and Elizinga (1984). Also see Howard and Stanbury (1990).

4. Concentration measures such as the Herfindhl-Hirschman Index (HHI) or the conventional four-firm concentration ratio (CR4) can be divided into two components: number of firms (N) and size inequality of firms (I). Concentration in an industry may be high because N is small or I is large or combinations thereof. The relative importance of these components in theory is not entirely clear. Kwoka's (1977) results suggest greater importance for inequality (dominance). Non-cooperative oligopoly models of the Cournot-Nash genre generally postulate equal sized firms. From time to time businessmen make representations to antitrust authorities on the disadvantages confronted by their relatively smaller firms. However, some rivalry models envision certain larger firms exerting procompetitive influence. See Scherer (1980) Ch. 5 and Porter (1979).

likely fall if the merging parties realize efficiencies which reduce marginal costs.[5]

In the absence of a unified or generally accepted theory of oligopoly, and the particular problems of realizing efficient scale of output in small markets, the foregoing discussion suggests that merger policy in countries such as Canada cannot be applied on the basis of a rigid set of principles. To do so would run a high risk of committing what Fisher and Lande (1983) have described as Type I or Type II errors. Type I error being one in which competition authorities prevent a desirable (efficiency generating) merger whereas Type II error is one which permits an anti-competitive merger. In other words, small economies are unlikely to be able to provide 'safe harbours' to parties in the form of Herfindahl-Hirschman Index (HHI) threshold levels as in the United States, or of dominant firm market share standards adopted in various other countries.[6] A collusion or incipient monopoly theory needs to be rejected in favour of a flexible cost-benefit approach towards mergers. This is in accord with recent developments in industrial organization economics which point out that the traditional high concentration-profits relationship may reflect efficiencies or superior competitive performance as against monopolistic practices.[7]

Also, as Stigler (1964) has pointed out, even if a collusive agreement can be arrived at, policing a cartel arrangement is difficult for member firms when the individual firm self-interests are not perfectly consonant. Powerful incentives to cheat exist whenever price exceeds marginal cost and companies feel price chiseling may go undetected. To maintain an effective cartel requires concurrence, coordination and compliance among members (see also Elizinga, 1984).[8]

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[5] See Eckbo (1983). See Warren-Boulton (1990) for further discussion including some problems with this approach. Various other methods based on market share stability, persistent high profits, etc. have also been put forward (not without controversy) to identify existing market structures which may display exercise of market power or cartel type behaviour. See also Elizinga (1984), Fisher (1979).

[6] The U.S. Department of Justice Merger Guidelines (1984) state that the Antitrust Division would not challenge a merger which increases the HHI values by more than 100 points in a market where post merger the HHI will exceed 1,800 points "only in extraordinary cases". In several Canadian merger transactions that have been allowed to proceed, the HHI values significantly exceed these thresholds. In Australia, the *Trade Practices Act* has adopted a dominance criteria in reviewing mergers. In administrative terms this has been applied to cases where a firm with more than 45 percent of the relevant market increases its post-merger market share to 60 percent or more. Acquisitions by firms which already meet this threshold are viewed as strengthening their dominant market position. Mergers giving rise to dominance or strengthening of dominance require authorization based on a public benefit criteria. See Khemani (1990) for summary information on various countries.

[7] See Goldschmid et al. (1974) and Paulter (1983).

Historically competition legislation in Canada has been applied on a case-by-case basis with emphasis placed on the conduct of firms rather than on the structure of industries. Early in the debate on reform of Canadian competition law, the Economic Council of Canada (1969, p. 10) stated that:

> What ever deficiencies may be laid at the door of Canadian competition policy, any allegation that it has amounted to a systematic, if futile, attempt to impose perfect competition on the economy cannot be sustained on the evidence of reports and cases under the Combines Investigation Act.

The Council advocated the adoption of a single objective for competition policy: the improvement of economic efficiency. Competition was not viewed as an objective in and of itself but as the single most important means of achieving efficiency. Industrial concentration was recognized by the Council as being one of the elements to be considered in the design of competition policy, but its degree of importance in the Canadian context was not deemed to be obvious. The importance of dynamic dimensions of competition, including the role of technological change, innovation and entry of new firms, was also stressed.

The dynamic aspects of competition and efficiency were given yet greater emphasis in the Skeoch-McDonald Report (1976). This report also cautioned against adopting a rigid approach towards formulating competition policy, particularly as it relates to mergers. The authors advocated instead the development of policies to alter the reaction pattern of the economy by continually imposing pressures which facilitated entry of new firms and a more flexible market environment.

These principles have been largely reflected in the substantive provisions and in the administration of merger policy under the *Competition Act*. No specific structural economic model is used in the application of the *Act*. Market conditions tend to differ across industries. The "hypothetical monopolist" concept employed by U.S. antitrust authorities as well as various existing and emerging literature on dominant firm behaviour and competitive strategies have been found useful in the merger review process (see Director of Investigation and Research, 1991). Despite the inherent oligopolistic interdependency problem in the Canadian economy, little evidence of collusive arrangements including 'facilitating' devices has been found. Without

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8. Hay and Kelley (1974) examined 62 price fixing cases and found that the mean number of conspirators was 7.25. A more comprehensive study of cases charging explicit collusion by Fraas and Greer (1977) found the mean number of conspirators to be 16.7. In Canadian cases the number of conspirators (counting both firms and individuals) found or pleaded guilty ranged from 1 - 20 with an average of 6.11 between the years 1965/66 - 1987/88. These statistics were computed from data presented in Stanbury (1989).

necessarily invoking an efficiency defense, merging parties in some cases have put forward various efficiency claims which, as the next section discusses, have been in part accepted by the Bureau of Competition Policy. In addition, in selected merger cases it has been possible to mitigate competition concerns through pro-competitive restructuring, including requiring partial divestitures to facilitate the entry of new, or growth of existing rivals and/or reduce the size inequality among firms. Changes in the business environment in which firms operate, for example the reduction in the levels of tariff protection, have also been used as part of the consent order process. While permitting legitimate merger transactions to proceed and paving the way for realization of potential efficiencies, such measures also reduce the extent of oligopolistic interdependence in a small economy. (For case specific examples see Crampton in Part 3 of this volume.)

3.0 MERGERS AND ECONOMIC EFFICIENCY

Canadian competition policy stresses the importance of economic efficiency and open, adaptable and flexible markets in order to provide consumers with competitive prices and product choices. Indeed, in this regard it appears that Canada is the only major industrialized country which has enacted an explicit "efficiency exception" to mergers in S. 96 of the *Competition Act*. That is, mergers which lessen competition substantially may nevertheless be permitted by competition authorities if they generate significant efficiencies that are greater than and offset the adverse price and other effects in the market, and that would not likely be otherwise attained.

The issue of efficiencies arising from a merger as well as its measurement remains a controversial and difficult subject. Various methodologies have been employed to assess pre- and post-merger situations. Studies using accounting measures of profits (see Ravenscraft and Scherer, 1987; Mueller *et al*. 1980; Meeks, 1977; Singh, 1971 among others) generally find a decline or no significant improvement in post merger profit performance. Similar results are found by Cowling, *et al*. (1980) who utilized a unit factor productivity measure in a series of case studies of mergers in the United Kingdom. In these cases changes in productivity were measured and balanced against evidence of market power in terms of profit margins. The net social welfare outcome was found to be at best neutral and at worst negative. Mueller (1985) using pre- and post-merger market share data found the relative market position of the merged firm to decline.[9] In contrast, studies using the capital asset pricing model based on stock market price data find that share prices of target firms tend to increase whereas those of acquiring firms remain approximately the same. In Canada, Eckbo (1986) discovered that the share prices of both acquiring and target firms increase post-merger announcement. Such findings are viewed as reflecting potential efficiencies arising from higher valued uses of target firm assets and the replacement of ineffective management through the process of the "market for corporate control." These interpretations of stock price movements have, however, not remained unquestioned, and some have suggested they are somewhat a transitory phenomenon (see Magenheim and Mueller, 1987; Ravenscraft and Scherer, 1987).

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[9] This may, however, be less an indication of post-merger decline in efficiency than of the practice of multiple sourcing policy by customers which results in shifting part of their purchases to rivals, particularly in cases of intermediate products.

The mixed results regarding the post-merger performance of firms does not necessarily imply a more proscriptive merger policy ought to be applied. The role of competition policy authorities is not to prevent businessmen from making mistakes. But, what is implied is that if the probability of improved post-merger performance is generally low, efficiency claims advanced by merging parties should be examined with extreme care if not conservatively. Such caution is also warranted for other reasons. Acquiring firms, pre-merger, will not normally have full and complete information on the cost structure and other commercial details of the target firms. This information assymmetry may give rise to significant errors in judgement about the post-merger efficiency gains. This possibility is buttressed by the experience in some merger cases reviewed under the *Competition Act*. Businessmen it seems tend to be overly optimistic in their estimates of potential efficiencies. In most cases efficiency claims have been revised downwards by Bureau of Competition Policy staff.

The Williamson (1968) model, which first formally postulated economic efficiencies as an antitrust defense, shows that it requires a very modest decrease in costs to offset the economic welfare effects of a significant post-merger price increase. This condition holds across a fairly wide spectrum of different demand elasticities. However, such results are dependent on what assumptions regarding pre-merger market power are made. Cowling *et al.* (1980) show that the net welfare effects of a merger can be negative if there already exists pre-merger exercise of market power.

The Williamson model has been described as being "naive." It is a static model and dynamic considerations such as whether growth in market demand would be sufficient to allow for exploitation of available economies through internal expansion and, the effects a post-merger price increase may have on the prices of non-merging firms and consequent welfare losses have not been factored into the analytical framework. Williamson (1986 and 1977) himself has expressed doubts on the practical applicability of the model in its present form. However, the model is rich in its implications for small economies such as Canada's and is a useful starting point in the evaluation of the economic effects of a merger.

Economists would generally tend to agree that a gain in efficiency is the reduction in real unit costs of production or distribution. These cost reductions are often likely to arise through:

(i) Economies of scale: when the unit cost of production decreases as the scale of output increases. These may be plant and/or product specific.
(ii) Economies of scope: when there are complementarities such that the costs of joint-production of two or more products is less than the costs of producing them separately.
(iii) Transaction cost economics: when there are savings associated with production within the firm as opposed to external purchases.

In practice, (see Goldman, 1988) these translate into merging parties predicting gains in efficiencies arising from various sources including (among others) better integration of production facilities, production line economies, distribution economies, accounting economies, specialization of inputs made possible by large scale production, increased ability to incur risks by a size-induced diversification, advertising and finance efficiencies, and the ability to spread the costs associated with research and development (see Director of Investigation and Research, 1991, Part 5).

Before such efficiency claims would be acceptable from a competition policy viewpoint, it must be demonstrated that the gains in efficiency would not likely be attained through alternative means which are less restrictive of competition, e.g. specialization agreements, joint ventures, contracting or licensing arrangements or a likely and less restrictive merger with another party. The onus to demonstrate this in Canada (and in the U.S.) is on the merging parties. Also, pecuniary economies such as those arising from a re-distribution of income between two or more parties possessing differential bargaining power are unacceptable.

Not all sources of efficiencies are quantifiable. Dynamic and other efficiencies such as improvements in product quality, introduction of new products and innovations, and increased product choice and service can not always be translated into price and cost terms. Thus, the Williamson type cost-benefit analysis, even as a starting point, has to be weighted taking into account relevant qualitative factors. Another issue that needs to be addressed is the market or markets upon which a particular merger may have an impact. The real world is not always comprised of single product, single market firms. As is often the case, a particular merger transaction may entail multiple and distinct product and geographic markets. The acquisition may not simultaneously give rise to a substantial lessening of competition in all markets. Moreover, if the gain in efficiency relates to product X and competition is lessened substantially in product market Y, the efficiency claims may not be viewed as being necessarily acceptable to competition authorities. To prevent the merger, potential economies may be foregone whereas to permit the merger the competition authorities run the risk of interpersonal comparisons of utility by making consumers of one product worse off than the other. If the efficiencies relating to X are not separable from the production of Y, the overall net welfare effects of the merger may likely have to be considered by competition authorities.

Given the structural characteristics of the Canadian economy discussed in Section 2, the Bureau of Competition Policy experience indicates that most of the efficiency claims advanced by merging parties are of the genre of increased plant or product specific economies of scale. To realize such economies, proposals have been put forward to rationalize production lines, close plants and increase specialization. Ownership and control of target firms is integral to such intra-firm post-merger restructuring. However, in some instances, the time period required for such rationalization through continued "competition" in an oligopolistic interdependent market is long and the foregone costs of potential efficiencies quite high. Moreover, alternative arrangements such as joint-ventures, licensing or contractual agreements, etc. have often not been prevalent practices in the industries examined which suggests such solutions may not necessarily be commercially practical or if considered, have been rejected by market participants on efficiency grounds.

It is worth noting that while merging parties have advanced various efficiency claims, there has as yet been no case where these efficiencies have had to be weighed in and of themselves against the substantial lessening of competition arising from the merger. In cases where acceptable efficiencies have been identified, other considerations such as effective foreign competition were also relevant in mitigating competition concerns.

The experience in Canada with respect to efficiency aspects of mergers seems to differ from that of the United States (Warren-Boulton, 1990). This may not be surprising in light of the differences in the relative size of the two economies. In a larger economy with a greater number of competing firms, most available economies would normally be exhausted. Any economies that may arise from a merger would have to arise from "firm specific" rather than "industry specific" characteristics. This, however, is not the case in the Canadian context where industry specific characteristics such as market size and tariffs have been found to importantly influence plant scales.[10]

The distinction between firm and industry specific characteristics also has important implications for administrative policy adopted towards accepting efficiency claims in anti-competitive merger situations. In the U.S. a fairly stringent policy appears to have been adopted by requiring that the efficiency gains be "unique" to the merging firms which another less anti-competitive merger cannot achieve and therefore are not otherwise achievable. In other words, only the transacting parties and no other firms can realize the identified efficiencies thereby emphasizing firm specific characteristics. To demonstrate this to be the case, the parties may have to show that there are no alternative buyers which could generate similar synergies. This, however, may promote 'free ridership' on the economic information or opportunities searched out by the acquiring firm by its rivals in the industry. It may also provide opportunities for strategic games by rivals which increase the costs of takeovers and impede the proper functioning of the market for corporate control.

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[10] Khemani and Shapiro (1990) found industry specific characteristics also importantly influenced company profits in Canada more than firm characteristics. Although the competitive process does push profit rates toward the competitive norm, inter-firm and inter-industry variation in profits does persist. Most profitable firms come from highly concentrated and product differentiated industries. Many low profit companies tend to persist due to tariff protection and/or government regulation.

The U.S. antitrust authorities have also adopted another stringent criterion by requiring the merging parties to demonstrate that the efficiency gains are likely to be of a magnitude such that there will not be any post-merger price increases and reductions in output. In the *U.S.* vs. *Archer-Daniels-Midland and Nabisco Brands, Inc.* the Department of Justice states:

> Only if those efficiencies are sufficient to offset the anti-competitive effects of the merger and ensure that prices will not increase can they save an otherwise illegal merger. In other words, in order to establish that efficiencies justify an otherwise illegal merger or acquisition, the merging parties must establish that efficiencies are so significant a magnitude and likelihood and market conditions are such that the cost savings will be passed through to consumers in the form of lower prices and increased output.[11]

For reasons of information asymmetry, overly optimistic business pre-merger expectations that need to be discounted, and the risks of committing Type II errors, competition authorities may indeed require that the efficiencies identified by the merging parties be of a significant magnitude. This would act as a price constraining influence even in cases of profit maximizing monopolists. However, depending on the shape of the firms' cost curves and demand elasticities, the criterion that post-merger prices and output levels remain unchanged appears to be overly stringent. It is one which would probably inhibit structural rationalization in small economies such as Canada's.

4.0 CONCLUSION

The theme of this paper has been that markets in small economies such as Canada's are more likely to be oligopolies in which potential efficiencies remain unexploited. This type of structural characteristic raises the risks of possible adverse economic effects in the administration of merger policy. An overly agressive or rigid stance by competition authorities towards mergers may prevent desirable efficiency-creating acquisitions from taking place, whereas an overly permissive policy may entrench monopolistic elements in the market. The relative economic consequences of these adverse outcomes will generally tend to be greater in small than in large economies.

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[11] *U.S.* v. *Archer-Daniels-Midland Co. and Nabisco Brands Inc.*, Memorandum in Support of Plaintiff's Motion in Limine Relating to Efficiencies, May 4, 1987, p. 4.

Also the task of administering merger policy is not made easier by the diverse range of models of firm behaviour and their economic welfare implications. These considerations suggest that merger policy should comprise of a flexible set of instruments which can be applied on a case-by-case basis to mitigate competition concerns while promoting economic efficiency. Williamson's counsel (1975, p. 249) is most appropriate in this context:

> For those who, like myself, are inclined to be eclectic, no comprehensive commitment to one approach rather than another needs to be made. What is involved, rather, is the selection of the approach best suited to deal with the problems at hand. Although the matching of models to problems is not always easy, I find the alternative of forcing one model to handle all the issues to be even less satisfactory.

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Chapter 10

RECENT DEVELOPMENTS IN CANADIAN MERGER LAW

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1.0 INTRODUCTION

In this paper we will seek to comment on Canadian merger law as it is practised before the Bureau of Competition Policy and before the Competition Tribunal at the present time (October 1989). It is not the purpose of this paper to review in detail the merger provisions set out in the statute, which has been done in several previously published papers.[1] The authors have had considerable experience in dealing with the Bureau on a number of mergers and have had some experience in dealing with the Competition Tribunal with respect to consent orders in merger proceedings. The practice, both before the Bureau of Competition Policy and before the Competition Tribunal, is very important not only to interested lawyers but also the development of competition policy in Canada.

There have been no decisions from the Tribunal or from the courts on substantive matters that might clarify the factors that surround a "substantial lessening of competition" in merger cases. But the Tribunal has delivered several procedural decisions in cases involving mergers and in other proceedings which impact on the expectations of those who have merger aspirations. Until there is more experience with the Tribunal, the approach taken by the Bureau is the only yardstick governing the acceptability criteria for mergers in Canada. Once the Tribunal has decided several contested mergers, the Bureau will still have the major role but there will be some guidance for it on substantive issues. A major theme of this paper is that such guidance will be slow in coming if a major modification in the existing approach is not developed, either legislatively or administratively.

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[1] See, for example, Anderson and Khosla (1986); Brander (1988); Goldman (1988a) (1988b) (1988c) (1989a) (1989b) (1990a) (1990b); Crampton (1989); Stanbury (1986); and Wetston (1988).

2.0 THE BASIC STATUTORY SCHEME

The *Competition Act* of 1986 adopts a three-pronged approach towards scrutinizing mergers in Canada.[2] The first prong is in the notification provisions which require notification of major mergers to the Director before they may be consummated.[3] The second prong is the ability of the Director to bring the merger before the Tribunal for its review where he believes that the merger lessens competition substantially. The third prong is for the Director and the acquiror to agree upon an effective resolution so there would clearly be no substantial lessening of competition if the merger proceeded and to take that agreement before the Tribunal for a consent order. In practice there may also be a fourth prong, which is not specifically sanctioned in the statute, pursuant to which the Director would accept undertakings from the acquiror or proposed acquiror and not proceed before the Tribunal at all.[4]

2.1 Notifiable Transactions

A transaction is notifiable only under certain specified conditions that in general sweep in most acquisitions but satisfy the size of the parties threshold and the size of the target threshold.[5] The size of the parties threshold is generally satisfied when the aggregate value of the gross Canadian assets or gross revenues from sales in, from or into Canada of the acquiror and the target exceed $400 million. The size of the target threshold is generally met when the target has gross Canadian assets or gross revenues from sales in Canada in excess of $35 million. In most instances this is simply a numerical calculation and it is not difficult to determine if the statute applies as the regulations are quite specific in their application.

Of more difficulty is the scope of the notification obligation to different types of proposed transactions and exemptions from the obligation. With respect to asset acquisitions the part applies in respect of a proposed acquisition of any of the assets in Canada of an operating business that exceeds the $35 million limit. The asset acquisition does not have to be the acquisition in whole or in part of a business of a competitor although that is the test for an application to the Tribunal under the substantive provisions. For example, the acquisition of an aeroplane or a ship from an entity that in no way competed with the acquiror but had used in its business for transporting goods or executives, would be caught by the rule even though the Director could not make any application to the Tribunal for relief. In practice however, the Director would likely issue an advance ruling certificate so no notification would be required (see Canada, 1988b). Sometimes parties wish to close the transaction faster than the Bureau can process advance ruling certificates. In that case, the Bureau will often issue a no action letter or will accept a short form notice which permits the proposed transaction to be completed after seven days.

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[2] R.S.C., 1985, c. C-34; the sections were renumbered effective December 12, 1988.

[3] See Roberts and Hewart (1986) and Wetston (1989).

[4] For critiques, see Stanbury (1991) and Maule and Ross (1989).

[5] See Part VIII of the *Competition Act*, sections 108-124 and "Notifiable Transactions Regulations," SOR/87-348.

There is also an exemption available for acquisitions of real property or goods in the ordinary course of business if the acquiror would not, as a result, hold substantially all of the assets of an operating segment of a business. This exemption often proves useful in limiting the scope for what might be called peripheral asset acquisitions.

Surprisingly enough, it is not the overreaching of the notifiable transactions but the underreaching of the notifiable transactions that may cause a problem. This arises because the notification only applies to the acquisition of voting shares which means shares that carry voting rights under all circumstances. Accordingly, if the acquiror purchases convertible securities from the target, even if coupled with an agreement that the acquiror is entitled, directly or indirectly, to appoint a majority of the directors, no notifiable transaction occurs. Transactions only become notifiable upon the exercise of the conversion right and there is no method in the statute to require the Director to give the parties any indication of whether an attack is likely to be forthcoming. This is true even if the document establishing the conversion right makes it clear that the conversion will be forced at the end of a time period. Often the use of the convertible debenture is essential to the parties in order to establish a debt relationship at the outset when control is acquired. The idea that the conversion right should trigger a new notifiable transaction with a waiting period of twenty-one days is counter intuitive. The Director could issue an advance ruling certificate under section 102, which would make the transaction immune from attack but the Director has taken the view that there is no "merger" until such time as the securities are converted into voting shares. While an advance ruling certificate would not alleviate the parties from the necessity of notifying under section 114 when the conversion right was exercised, the parties would feel much more secure that an attack under section 92 would not be mounted.

The present reaction from the Director does not accord with business reality. It may be that the Director could get out of this dilemma by the utilization of section 119 which provides:

> When notice is given and information supplied in respect of a proposed transaction under section 114 but the transaction is not completed within one year thereafter or such longer period as the Director may specify in any particular case, section 114 applies as if no notice were given or information supplied.

Utilizing this provision, the Director could specify the period of conversion (which is often two or three years) rather than the one year period specified in that section and take the notice given at the time the transaction was entered into as the notice required pursuant to section 114. So far the Director has not been willing to countenance that alternative.

The notification provisions also apply to amalgamations but in that case notification is only required if the aggregate asset value or the aggregate gross revenues from sales of the amalgamated corporation exceeds $70 million. Most amalgamations now proceed with a subsidiary of one company that is set up for that purpose ("Amalco") which amalgamates with the target. As Amalco normally has no money, in effect the ceiling for the target is doubled.

As indicated above, a transaction may not be completed within seven days of the filing of a short form notice or within twenty-one days of the filing of a long form application. In practice the Director will take considerably longer than twenty-one days to review a merger where there are significant competition concerns. The Bureau is extremely busy and it is doubtful that an advance ruling certificate could be expected in a shorter period than three weeks.

2.2 Contested Merger Review

Where the Director believes that there is a likelihood that a proposed merger would lessen competition substantially,[6] he is obliged to go to the Tribunal unless he can alter the transaction in such a way that he believes no substantial lessening of competition will occur. In any merger brought to his attention, the Director is therefore required to determine if any substantial lessening of competition, in his view, has occurred. This underlines the important role of the Director. He acts like a one-way valve as nobody else has access to the Tribunal. If one can convince the Director that there is no substantial lessening of competition, there will be no Tribunal hearing. The Director has encouraged consultation in merger matters and that consultation almost always involves a decision as to whether the Tribunal would be involved or the matter can be settled directly with the Director.

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[6] For some indication of how the Director interprets this critical phrase, see Director of Investigation and Research (1991).

To date, the Director has not been entitled to rely on the ability of the federal Crown to enforce commitments given to the Director. As we understand it, the argument is there is no specific statutory provision which permits the Director to rely on undertakings. There is authority in a recently decided case in the Supreme Court of Canada that the Director is limited in his ability to act when there are no enabling words in the statute. On the other hand, it would seem to be common sense that the ability to accept and enforce undertakings would be necessarily incidental to his function. However, other bodies are specifically given the power to accept undertakings in their statutes while the Director is not.

There is now a three-way approach when the Director believes that a merger may substantially lessen competition. If the transaction has not closed, the Director may agree with the parties that certain remedial action would remove his concerns and that remedial action can be taken before the transaction is finally consummated. In that way there is nothing for the Director to enforce.[7] If the remedial action cannot be completed in the time frame acceptable to the parties to the merger, then the Director will shape a consent order acceptable to both parties and make an application to the Tribunal as the Tribunal order is clearly enforceable. The consent order concept is authorized by section 105 of the statute. It has been used on a few occasions, including the Imperial Oil/Texaco merger.[8] The third route is for the Director to press a contested application before the Tribunal and let the Tribunal decide whether or not there has been a substantial lessening of competition and, if there has been, to make an order under section 92. To date, no proceedings has gone that far.[9] Indeed the apprehension of the business community is such that the number of mergers that will be considered fully by the Tribunal will probably be very few at least until some jurisprudence is developed.

There is a respectable body of opinion in the United States that an adversarial approach to decision making is inherently incapable of dealing with the economic complexities of merger law. Enforcement decisions in respect of proposed mergers require the application of indeterminate economic theories; respected expert economists frequently advance contradictory conceptions of barriers to entry and the weight to be given evidence of potential import competition to take two notable examples. In 1975, then Professor Richard Posner (now U.S. Court of Appeal Judge) asserted that:

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[7] This approach has been referred to as "fix it first." By resolving those aspects of a transaction which give rise to concerns of substantial lessening of competition, the grounds on which the Director can refer the merger to the Competition Tribunal are removed. See Goldman (1988a) (1989a) (1989b) (1990b).

[8] The initial consent order application was referred back to the Director and subsequently issued by the Tribunal with modifications. See Schultz (1989) (1990) and Stanbury (1991).

[9] In 1990 and 1991 the Director brought two contested applications - see *Canadian Competition Policy Record*, Vol. 11(4), 1990, pp. 1-2; Vol. 12(1), 1991, pp. 3-4 (re Southam newspapers in B.C.); and Vol. 12(1), 1991, pp. 1-2 (re Canada Packers Inc.).

> Rebuttal based on ease of entry, economies of scale, or managerial efficiencies should not be allowed [in merger cases], because these factors, though clearly relevant to a correct evaluation of the competitive significance of a merger, are intractable subjects for litigation (Posner, 1975, p. 313).

There is persuasive evidence from the United States experience with merger regulation to support Posner's assertion. Shortly after the *Clayton Act* anti-merger provisions were enacted in 1950, the Federal Trade Commission (the "FTC") eschewed a simplified market structure standard and attempted to assess the competitive effects of proposed mergers through a wide-ranging analysis of all relevant structural and behavioural factors. The Commission's performance under the comprehensive standard was criticized, not for the substantive content of its decisions, but for the unusually lengthy hearings which resulted from its attempts to conduct broad economic investigations as civil trials.[10]

In our view, if any significant jurisprudence is to be developed within a reasonable time frame, it can only be developed by the Director and the Tribunal taking smaller steps than the examination of the totality of a merger. If those smaller steps are not able to be accomplished administratively under the wording of the *Competition Act* as it stands, then an amendment of the statute is necessary. An all or nothing approach makes the Director's job more difficult and undermines the efficacy of the Competition Tribunal. As the experience with the International Court of Justice clearly demonstrates, the existence of a tribunal does not ensure continued use if the tribunal does not respond effectively to the concerns of those who can initiate proceedings before it. The Competition Tribunal needs to gain the Director's confidence.

One way of limiting the scope of a proceeding before the Tribunal would be to bring discreet questions, albeit in the context of a proposed or completed merger, before the Tribunal for review. To some extent this seems to be contemplated in the statute in that a merger is defined in section 92 to mean the acquisition of control over or significant interest in a part of a business. Accordingly, where the Director applies to the Tribunal under section 92, the application could relate only to a part of the business being acquired. This is the position favoured by the Director and if the Tribunal accepts that approach it will encourage both businessmen and the Director to use the Tribunal. While businessmen cannot directly approach the Tribunal, they can veto any proceeding by the Director in front of the Tribunal by simply refusing to go ahead with the acquisition. In that negative sense, businessmen control the development of the jurisprudence and have exercised that veto in every instance in which the Director threatened to bring a fully contested proceeding before the Tribunal.[11]

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[10] See Bok (1960, pp. 33-39) and Stigler (1955, p. 182).

In the United States, both the FTC and the federal courts have responded to the pervasive conflict between indeterminate economic theory and the delay and distortions inherent in adversarial trial-type procedures by applying a gloss to the statutory standard of "substantially to lessen competition or to tend to create a monopoly" that radically simplifies the economic content. During the 1960s, the U.S. adjudicators of contested merger cases developed a presumptive market share standard for horizontal mergers which relied on the merged firm's market share and the overall level of market concentration resulting from the proposed transaction as the primary decisional criteria. This form of legal inquiry thus simply ignored other structural and behavioural factors which are often critical to the predication of a merger's competitive consequences. The presumptive market structure standard was endorsed by the U.S. Supreme Court "...in the interest of sound and practical judicial administration."[12]

In Canada, the key test to differentiate an acceptable merger from an unacceptable merger is the likelihood that the merger will prevent or lessen competition substantially, which is the same test as that found in the *Clayton Act*. While these words are not defined in the Canadian statute, the statute gives some indications of what those words mean. First and foremost, subsection 92(2) states that the Tribunal shall not find that a merger is likely to lessen competition substantially solely on the basis of evidence of concentration or market share. To some extent this is counter-intuitive and contrary to the position taken in the United States, which is generally the source looked to by the Bureau and by the acknowledged experts in the field.

The evils seen to arise from a merger in the U.S. literature relate either to the facilitation of collusive behaviour or the increase in market power brought about by an increase in market share. In Canada, the statute makes it clear that increasing one's share of a market very substantially is not of itself enough to say that competition has been lessened substantially.[13] In other words, reliance on concentration ratios or on the Herindahl-Hirschman Index is not appropriate. Accordingly, despite the similarity of words between the

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[11] This would heighten the risk of committing Type II errors referred to by Khemani in Part 3 of this volume.

[12] *United States v. Philadelphia National Bank* (1964), 374 U.S. 321 at 362 (Brennan J.).

[13] The Director's *Merger Enforcement Guidelines* (1991, p. 21) indicate that he will not challenge a merger on the basis that the merging parties will be able to unilaterally exercise greater market power in the absence of the merger where the post-merger entity's market share is less than 35%. He generally will not challenge a merger on the basis that the interdependent exercise of market power by two or more firms where, after the proposed merger, the market share of the four largest firms would be less than 65% or the post-merger market share of the merged entity would be less than 10%.

Canadian statute and its American counterpart, the concept of "lessen competition substantially" will be decided differently in the two countries.

Since the definition of lessening competition in the merger provisions of our statute will be difficult, if it can be resolved in stages that will be the preferable course to follow. For example, in determining what lessens competition substantially one has to take into account the extent to which foreign products or competitors are likely to provide effective competition to the businesses of the parties to the merger (see Crampton in Part 3 of this volume). Absent trade barriers, the proximity of Canada to the United States ensures in most businesses that foreign entry is likely if the profit margins are sufficient. The American literature suggests that it is not entry, but threat of entry which keeps the domestic producers in line and makes competition effective. Just how one weighs the qualitative "effective competition" of section 93(a) against an increase in market power, is far from clear. The Bureau appears to have accepted that a merger which results in duopoly or perhaps even in monopoly is acceptable where the threat of foreign competition is real.

On the other hand, another factor impacting on "competition" in the merger provisions is the likelihood that the merger will result in the removal of a vigorous and effective competitor. A horizontal merger by definition removes a competitor from the market and the prognosis is normally made that the acquiror will pick up the bulk of that eliminated competitor's market share. Assuming that market share is not insubstantial, it is not clear how one could say that the competitor was not "effective." If this is correct, the importance of the word "vigorous" is enhanced. If somehow the Director could, in the confines of a particular case, refer a specific situation to the Tribunal to determine whether the target was a "vigorous and effective" competitor, without determining whether or not there was a substantial lessening of competition, that would be most helpful.

The existing competition Tribunal rules do not appear to contemplate this type of application by the Director to the Tribunal but presumably could be amended to do so. The concept of an originating notice of motion to clarify points of law in particular fact situations involving mergers that are still at the Bureau stage, would be most helpful to the Director and to the parties dealing with him. It would also allow the community to develop confidence in the Tribunal itself. In our view, this building of confidence is essential if the innovations introduced in 1986 are to become effective.

In the *Chrysler* decision there has been a specific finding by the Competition Tribunal that market definitions may be entirely different in merger proceedings as contrasted with refusal to deal proceedings.[14] There is also the passing recognition in that case that the question of "substantially lessening competition" may depend on an analysis of the likely changes in price as a result of the merger. The Tribunal also found that the word "substantially" which is used in the refusal to deal section as well as in the merger section, should be given its ordinary meaning, which means more than something just beyond *de minimus*. The Tribunal said that "while terms such as 'important' are acceptable synonyms, further clarification can only be provided through evaluations of actual situations." The business community will be encouraged by this approach to substantiality and this will increase its confidence in the Tribunal.

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[14] See *D.I.R. v. Chrysler Canada Ltd.* (1989), 27 C.P.R. (3d) 1 and the discussion in Crampton in Part 3 of this volume.

2.3 The Efficiency Exception in Canadian Merger Law

Canadian competition law is somewhat unique among the antitrust laws of developed industrialized capitalist economies in that it provides an affirmative exception to the Act's merger provisions in cases where efficiency gains expected to be realized from a proposed transaction are sufficient to offset any substantial lessening of competition that may be attributable to it. Section 96(1) of the Act provides that the Tribunal:

> ...shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order were made.

This part of the paper will review some of the salient issues which will need to be tackled by both the Director and the Tribunal in interpreting section 96(1).

First, in considering the balancing analysis incorporated in section 96 it seems that both quantitative and qualitative elements are appropriate parts of this trade-off analysis.[15] If the trade-off or balancing analysis is limited to only those factors which are capable of reliable quantitative measurement, the balancing analysis would exclude a number of "soft" variables which are logically relevant to the *Act*'s stated policy goals. For example, improvements in product or service quality are much more difficult to estimate in quantitative terms than are anticipated cost reductions that will be causally attributable to the proposed transaction.

In our view, a purely quantitative approach to the balancing analysis is clearly not what Parliament intended. One reason why a purely quantitative approach would be impractical is that, in many instances, the Director's staff and the Tribunal would be required to add "apples and oranges." For example, a merger which rescues a failing firm from bankruptcy proceedings should be analysed as a trade-off or balancing problem focusing on the social harm from a substantial lessening of competition and attempting to compare it with a social benefit that rescues a firm from the social costs of failure.[16] In this context, if an arm's length buyer is willing to purchase a failing firm and operate it as a going concern, that is probative evidence that saving the firm is a better use of society's productive resources than dismantling it. But such a potential gain in society's economic welfare is incapable of reliable quantitative estimation, and for that reason it is difficult to balance against the economic costs of the substantial lessening of competition.

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[15] The Director's views can be found in his *Merger Enforcement Guidelines* (1991, Part 5).

The second condition of sub-section 96(1) provides that the Tribunal shall not prohibit a proposed transaction because it would substantially lessen competition if it would create more than off-setting efficiencies and "gains in efficiency would not likely be obtained if the order were made." The quoted language could arguably refer both to "alternatives to the merger" and alternative merger partners. The two possible interpretations are not logically inconsistent or contradictory. We believe it is right to reject an interpretation which would require the parties to the proposed transaction to demonstrate that only a merger of their businesses would be capable of achieving the greatest efficiency gains, or, stated in different language, that there is no other alternative merger partner that offers a comparable level of efficiency gains as a result of a merger with the proposed target company. The more difficult policy issue is assessing when alternatives to a merger transaction are likely to be equally effective in achieving the efficiency gains claimed for the proposed transaction. In addressing this issue several commentators have argued that efficiency gains which can be feasibly attained through alternative means such as specialization agreements, contractual arrangements, licensing or joint ventures should not be considered in the balancing process under subsection 96(1).

We think this opens up a number of difficult questions concerning the practical comparability of a merger and, for example, a research and development joint venture in achieving, say, dynamic efficiency gains. Proponents of proposed mergers may reject joint venture arrangements because they endanger the confidentiality of proprietary information, or because managements of the other firms in the industry that are willing to enter into such arrangements demand an unfairly large share of future profits. Again the problem of subjective considerations, and the extent to which they can be brought forward as justifications for rejecting alternatives, will need to be dealt with in future enforcement decisions.

The same kinds of problems arise with respect to drawing comparisons between specialization agreements and mergers as alternative ways of achieving efficiency gains in a particular case. Proponents of mergers may put forward arguments concerning the potential for exposure to strategic behaviour by prospective partners in such contractual arrangements. They may raise security of supply concerns, labour problems, etc.

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[16] The failing firm issue was central in the Director's decision not to challenge PWA Corp.'s purchase of Wardair Inc. See *Canadian Competition Policy Record*, Vol. 10(2), 1989, pp. 8-9.

We also disagree with the frequently stated proposition that the burden of proof to establish the factual basis for a section 96 defense rests on the proponents of a transaction which the Tribunal determines is likely to substantially lessen competition. It is true that the proponents are likely to be the only source of some kinds of relevant evidence (i.e., sales data, company-specific cost data, etc.), but much of the relevant evidence will depend on information and knowledge that is likely to be shared by all members of an industry, their advisors and consultants, academics, public sector researchers and others. In any event, the Act makes no reference to the burden of proof. If the proponents invoke the efficiency exemption and tender credible evidence in support of their claim, we believe the burden will shift to the Director to establish the contrary on the balance of the probabilities.

3.0 DEALING WITH THE BUREAU

Any potential acquiror today must assess the competition concerns, if any, raised by the proposed acquisition. The first and often the most difficult problem is to identify what the Bureau will or will not be concerned about. Many businessmen and many lawyers are not familiar with the extensive Canadian literature, much less with the U.S. literature, that identifies when the Bureau might have or should have concerns that the outcome is likely to lessen competition.[17] Lawyers in our office will say to us, "but they do not make the same products so of course there is no competitive concerns," disregarding entirely potential for entry. Recently a client of our office was surprised that the Bureau looked with suspicion on the fact that Canadian producers in an industry charged a higher price in the domestic market than in the export market. The client explained that this was normal because one needs to recoup only variable costs outside the home market, but must also recoup fixed costs in the home market. To express the argument in quite such simplistic terms would be unlikely to allay the Bureau's concerns.

The competition concerns of the acquiror should also be concerns of the target. If the target does not wish to be acquired, the Bureau may be a weapon that can be used to cool the acquiror's ardour. In the more usual case in Canada where the acquisition is friendly, the target does not even contemplate that the deal may be blocked with the result that the top dollar suitor is no longer in the running while the target is still up for grabs. Normally potential acquirors have as a condition of the transaction closing that the Bureau has not initiated any proceeding that threatens the acquisition. The threat or lack thereof by the Bureau may often depend on how well the case is put to it. In cases that are likely to be sensitive, the target may want some assurance as to input into the content of the brief to be submitted to the Bureau and should certainly want assurance that the person charged with presenting the brief is knowledgeable.

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[17] The uncertainty has been reduced by the Director's *Merger Enforcement Guidelines* published in March 1991.

If acting for an acquiror in a sensitive case it is most important that the first presentation to the Bureau be fulsome and forceful. The Bureau staff is capable and works hard. Since the new Act and Cal Goldman got there in 1986, the visibility of the Bureau in Ottawa has risen dramatically. And Howard Wetston, who has been the top working figure in most major merger investigations, has been able to galvanize his troops into effective, sustained action.[18] But the Bureau has been stretched in these days of attempted restraint and does appreciate the applicant supplying not only the raw data but also addressing the competition concerns. The first rule however is to make sure your data is accurate or at least defensible. Lawyers who lack experience in this area may rely entirely on the client to supply the data about the market as well as about itself. Sometimes this is appropriate, especially if the client is sensitive to competition law concerns. More often however, the market information is better obtained from an independent source. Generally speaking, each industry has its own statistical gatherer, sometimes in the form of a trade association and sometimes an independent party doing its own research. The provincial governments have often done studies and issued reports of the industry within the province. This data will be treated as authoritative unless disproved. Similarly, Statistics Canada data is often available and useful, even though the industry may distrust it.

Compiling the data is only one part of the job. Examining the literature, particularly in the United States, to see how similar situations have been dealt with can be most helpful. Sometimes the client will know of an example that "got through." This is only relevant if one can produce the written reasons why that acquisition was accepted. Of more importance is to look at reported U.S. cases in the same industry for product and geographical market definitions and factors other than market share that influenced the judge. And there is also room for inventive arguments. The better the brief, the better your chances of success.

We try to contact the Bureau to advise it that the brief is coming a day or so before sending it. We believe it is essential to open the channel of communication and keep it open. After the brief has been there a few days, we telephone the Bureau and offer to come down and explain our position. If the Bureau feels that it is a sensitive acquisition, the offer is normally accepted and a meeting arranged. Usually through dialogue an acceptable result can be obtained. But the Bureau will not be stampeded and continual badgering is not as productive, in our experience, as well documented logical arguments. While the Bureau cannot ignore the political overtones entirely, it is remarkably free from political interference. However, it is very sensitive to media reaction. The lower the media profile, the smoother the ride as the Bureau can focus on the competition concerns and ignore other factors.

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[18] Mr. Cal Goldman stepped down as the Director on October 31, 1989 to re-enter private law practice. He was succeeded by Mr. Howard Wetston as the Director.

The Bureau staff is busy and does not want to waste time. In many cases where there is no major competition concern, it likes to react swiftly and get on to the next problems. The applicant can help the Bureau by providing a comprehensive brief which is easily verified, without the Bureau needing to do extensive basic research. So even in cases where the sensitivities are low it must be remembered that the Bureau is required to investigate and not just assume. To the extent one can assist the Bureau, one assists oneself. The Director ultimately holds the trump card as most deals will collapse if he refuses to let them go forward. Accordingly, it is a question of convincing the Bureau that there are no competition concerns.

4.0 THE COMPETITION TRIBUNAL

The experience in merger cases before the Tribunal to date has been mainly related to consent orders. Consent orders are specifically envisaged under section 105 which provides:

> Where an application is made to the Tribunal under this Part for an order and the Director and the person in respect of whom the order is sought agree on the terms of the order, the Tribunal may make the order on those terms without hearing such evidence as would ordinarily be placed before the Tribunal had the application been contested or further contested.

The section is not confined to merger matters but has only been used in that area.

The first question which arises is whether the Director must make an application under one of the specific sections dealing with reviewable matters and then join the consent order application to that first application. In a merger proceeding, the Director takes the view that he must allege some substantial lessening of competition as a result of the merger which substantial lessening is alleviated by the proposed consent order. The Tribunal has not ruled on whether this approach is procedurally correct but it has indicated that it is substantively irrelevant. Thus the Tribunal has stated that the comparison is between the state of competition before the merger and after implementation of the proposed order. If there is no substantial lessening of competition in that comparison that ends the matter and what would happen without the proposed consent order is not relevant. There is no need for the acquiror to agree with the Director's allegation of a substantial lessening of competition absent the consent order and to do so is unwise as the agreement might be used against the acquiror in the event of a subsequent proceeding.

The Tribunal has not followed the usual approach of Canadian courts to consent order-type proceedings.[19] For example, the *Canada Business Corporations Act* provides that the Director appointed under that statute may commence an oppression action and the Supreme Court of Canada has confirmed the Director's role as *parens patriae* in such proceedings. Any such action may only be settled with the consent of the court which raises the question of how involved the court should be in any such settlement. In a recent case involving Southam and Torstar, the Ontario Court, speaking through Mr. Justice Anderson, held that the Court should only refuse to approve the settlement if there was a manifest error. He pointed to the Director as the person charged to represent the public interest once he commences a proceeding and a strong presumption in favour of a settlement approved by the Director results.[20]

The Competition Tribunal has taken a different approach. In the *Palm Dairies* case, which was the first case to go to the Tribunal and was an application for a consent order, the Tribunal refused to grant the order at all, making it clear that the Tribunal was not going to be a "rubber stamp."[21] In a subsequent decision, the Chairman specifically rejected the approach of the Ontario Court under the *Canada Business Corporations Act*.[22] It is difficult to discern the role that the Tribunal expects to play in consent order proceedings. The section clearly contemplates the order going through without hearing the evidence that would be heard in a contested proceeding. The Director has thoroughly examined the situation before the order is applied for and determined that there will be no substantial lessening of competition. Normally, several outside experts hired by the Director have come to the same conclusion. Why then would the Tribunal seek to examine the substantive issues again in the absence of manifest error? Yet in all the consent order applications so far concluded, the Tribunal has made suggestions that resulted in changes being made to the consent order.[23]

The consent order process is still evolving. Whether it will be an effective adjunct in merger enforcement remains to be seen. It does give the public access to the proceeding and allows the Tribunal to see, as Professors

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[19] See the discussion in Stanbury (1991), Schultz (1990) and Goldman (1990b).

[20] *Sparling v. Southam Inc.* (1988) 66 O.R. (2d) 255 (H.Ct.).

[21] (1986) 12 C.P.R. (3d) 540. See Goldman (1990a).

[22] See *Gemini* (1989) 27 C.P.R. (3d) 476. But see also *Re D.I.R. and Asea Brown Boveri Inc.*, "Reasons for Consent Order Dated June 15, 1989," September 6, 1989, CT89-1, p. 17.

[23] This is in stark contrast with the experience of antitrust agencies in the United States under the *Tunney Act*, where all consent order applications have been permitted to proceed substantially unchanged.

MacCrimmon and Stanbury (1978, p. 93) put it "that competition policy is working as it is intended to work."

5.0 CONCLUSION

The merger practice before the Bureau of Competition Policy is evolving quickly in a satisfactory manner. There is however a need to permit the use of undertakings contemplating future action which undertakings would be specifically enforceable by the Director. Similarly, there needs to be a process for referring specific points to the Tribunal for resolution without resorting to a full scale application. In our view these alterations should require no statutory change. It is highly unlikely that a major corporation would simply disregard undertakings in any event and there are methods to ensure this result, if necessary, by bringing in third parties to whom the undertakings can be addressed. The referral of specific questions to the Tribunal could be remedied by changing the Competition Tribunal Rules.

The basic system is working well at the Bureau level. But the interface with the Competition Tribunal is not yet well developed.

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Chapter 11

RELEVANT MARKET ANALYSIS IN RECENT MERGER BRANCH DECISIONS

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1.0 INTRODUCTION

Although there is no specific mention in section 92 of the *Competition Act* of 1986 (the "Act") of the terms "relevant market" or "market", the fact that these words[1] appear in the section 93 list of evaluative criteria clearly suggests that Parliament intended that the issue of whether competition is likely to be prevented or lessened substantially be resolved by reference to a meaningful antitrust market. It would appear that no definition was provided for the terms "relevant market" or "market," *inter alia*, because of the difficulty associated with finding terminology that was flexible enough to accommodate the diverse types of situations that are addressed throughout the Act. It was obviously decided that it would be more appropriate to leave the resolution of this issue to the Competition Tribunal which is given the responsibility for adjudicating the civil reviewable matters under the *Act*, including mergers.

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[1] It is significant that the Tribunal has employed the terms "relevant market" and "market" interchangeably with respect to the market in question. See the recent decision in *D.I.R. v. Chrysler Canada Ltd.* (1989), 27 C.P.R. (3d) 1 (discussing the Canadian market for Chrysler auto parts). The implications of Parliament's use of these two terms in section 93 are discussed in P.S. Crampton, *Mergers and the Competition Act* (Toronto: Carswell Legal Publications, 1989), at p. 261 note 2, and corresponding discussion in text.

The decision in *Chrysler*,[2] a refusal to supply case, appears to indicate the Tribunal's endorsement of this approach. There, it implied that a general definition would not be appropriate, when it observed that the approach to defining markets "may be entirely different", depending on the "particular context" and "particular purpose" in relation to which markets must be defined under the Act.[3]

Given that the Tribunal was dealing with section 75 of the Act, which focusses upon the effect of a refusal to deal on the business of the person refused supplies, it held that the starting point in market analysis under that provision is the buyer's customers.[4] This approach was contrasted with the case of a merger, where: "...the ultimate test is whether the merger will substantially lessen competition and the definition must be consistent with the attempt to determine whether the merger will result in an increase in prices or in other effects consistent with a lessening of competition."[5]

It should be apparent from the foregoing that the assessment of relevant markets in competition law analysis does not begin with a search for an entity that has well defined characteristics which can be objectively identified and recognized by one and all, or that exists independently of the firm or firms whose conduct or proposed conduct is being examined. Rather, relevant markets are artificial constructs that are created for the purpose of assessing particular competition law matters, e.g. the issue of market power.[6] Accordingly, there is much scope for taking the set of facts that are presented in any given case and fashioning this entity broadly or narrowly. Given that the relative competitive significance of particular firms' market positions usually[7] decreases as the parameters of the relevant market within which they are said to compete are expanded, conclusions that certain conduct contravenes the Act are often very sensitive to the dimensions of these parameters. For this reason, the preparation of a well articulated case with respect to this issue is, to say the very least, of central importance, and has profound implications for everything that follows in merger analysis.

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[2] Ibid.

[3] Ibid, at 15.

[4] Ibid, at 16.

[5] Ibid, at 15-16.

[6] If it was possible to determine, in the time frame within which competition law assessments must be carried out, the elasticity of demand and supply facing particular firms, it would not be necessary to create relevant markets. See generally W. Landes, R. Posner, "Market Power in Antitrust Cases". 94 *Harvard Law Review* (1981) 937 at 962.

[7] In view of the fact that the scope for competitive overlap increases as the relevant market is broadened, there have been cases where competition law authorities have successfully challenged mergers by establishing that the parties to the transaction were in the same, as opposed to distinct, markets. See for example, *U.S. v. Continental Can.*, 378 U.S. 441 (1964); and *FTC v. PPG Industries*, 628 F. Supp. 881 (D.D.C. 1986).

Unfortunately, notwithstanding the critical importance of relevant market analysis in merger review, there is currently a lack of Tribunal decisions, statutory criteria and Bureau of Competition Policy public documentation to further the understanding of interested observers with respect to this complicated subject. This paper therefore attempts to provide some assistance in this regard by briefly outlining in Part 2 the approach that has been taken by the Bureau in recent case analyses to various important issues relating to relevant markets; by providing in Part 3 a brief list of various criteria that have been examined by the Bureau in determining the factual bounds of relevant markets in particular cases; and by providing in Part 4 what are hoped will be helpful examples of specific case assessments.

2.0 GENERAL APPROACH TO RELEVANT MARKET ANALYSIS

It is important to note at the outset that the Bureau has been recently examining its approach with respect to many of the issues that will be discussed below. Accordingly, while it is hoped that this paper will provide helpful insights into the various issues that arise and/or should be addressed in relevant market analysis under the merger provisions of the Act, it is also hoped that readers will not be misled to believe that a specific issue will in the future be resolved in a particular manner by the Bureau. In this regard, it should be kept in mind that the following discussion describes the approach that has been taken in *staff* assessment documents to relevant markets, and that the Director has from time to time adopted a different position.

Although no formal policy positions have yet been adopted by the Bureau with respect to the various threshold issues that arise in relevant market analysis, it would appear that a fairly consistent, albeit flexible, approach has been taken with respect to these matters. The first issue that must be addressed in any assessment concerns the selection of a framework of analysis. The cases and literature offer the following alternatives:[8] (i) a calculation of supply and demand cross-elasticities; (ii) an approximation of cross-elasticities through an impressionistic and intuitive assessment of the "reasonable interchangeability" of particular products; (iii) a similar, yet somewhat more sophisticated, method of approximating cross-elasticities, by evaluating the extent to which goods and services are close demand or supply substitutes; (iv) an assessment of price relationships; and (v) a determination of the smallest profitable ideal collusive group or hypothetical monopolist. For geographic market definition, additional frameworks of analysis that have been suggested include: (vi) the "shipments approach" and (vii) the "direct and immediate effects" doctrine of the U.S. Supreme Court.

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[8] See generally Crampton, *supra*, note 1, at 266-293 and 311-321. A further alternative that has been suggested is the "Residual Demand Analysis" econometric approach. This is discussed in D. Scheffman and P. Spiller, "Geographic Market Definition Under the U.S. Department of Justice Merger Guidelines," *Journal of Law and Economics*, Vol.XXX (April 1987) 123; and in J. Ordover and D. Wall, "Understanding Econometric Methods of Market Definition," *Antitrust*, Vol. 3, pp. 20-25.

2.1 Cross-Elasticities/Reasonable Interchangeability

Generally speaking, the assessment of relevant markets by Bureau staff has more closely resembled the hypothetical monopolist approach, which has its most renowned expression in the U.S. Department of Justice 1984 *Merger Guidelines*,[9] than any of the other approaches (see section 2.5 below). The word "resembled" is carefully chosen, because the terms "hypothetical monopolist" and "ideal collusive group"[10] have seldom made their way into Bureau staff assessment documents, where references to the U.S. *Merger Guidelines* have been equally rare. However, in spirit, the analysis appears to have been quite similar.

Reference is also regularly made to supply and cross-elasticities in conceptual terms. However, the resource limitations on the Bureau are such that it has never had the necessary statistical data to actually compute cross-elasticities or own-price elasticities; and these statistics have seldom been provided from external sources. A further limitation of such measures is that individual cross elasticities can provide a poor indication of the extent to which firms under scrutiny are *likely* to increase prices or otherwise exercise market power.[11] This is *a fortiori* the case with the related "reasonable interchangeability" and "substitutability" approaches. Although these notions, like cross-elasticity, are helpful to work with and have often been employed at a *particular stage* of relevant market assessment, their impressionistic and arbitrary nature render them less useful as a framework of analysis than as mere factors to take into account together with other considerations. Moreover, the "reasonable interchangeability" approach employed by courts in foreign jurisdictions has largely ignored potential supply responses.[12]

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[9] *U.S. Department of Justice Merger Guidelines*, (June 14, 1984). Reproduced in *BNA Antitrust & Trade Reg. Rep.*, No. 1169, Special Supplement. Cf. P. Bronsteen, "A Review of the Revised Merger Guidelines". *Antitrust Bulletin*, Vol. 29, (1984), pp.613-652.

[10] Boyer described the "ideal collusive group" in the following terms: "I propose to define an industry from the point of view of a single firm: to a firm, its industry is the smallest group of sellers such that, were all members of the group to collude, bringing additional members into the collusive group would give the firm only minimal short term advantage. In a sense, a firm sees its industry as the ideal collusive group. The notions of substitution on both the supply side and the demand side are subsumed in the definition. The criterion suggested would likely place producers of goods which are not substitutes in a different industry, since those producers are not likely to constrain the decision making of industry members, and thus their addition to the group would not be a significant advantage.

"Similarly, if a firm does not currently produce a good substitute to the industry's products, but could in the short term, the existence of such a firm would constrain the business behavior of the industry members and there should be a definite interest in including this firm in any collusive scheme. The length of time considered to be "short" will arbitrarily separate industry members from potential entrants. If the run is long enough, there will be no potential entrants, only members of the industry" (K. Boyer, "Industry Boundaries," in T. Calvani, and J. Siegfried, *Economic Analysis and Antitrust Law* (Toronto: Little, Brown & Co., 1979), pp. 88-106, at 92).

2.2 Price Movements

Like cross-elasticity, reasonable interchangeability and substitutability, price relationships do not appear to have been relied upon as a framework of analysis, but have been routinely included among the various *particular factors*[13] that have been examined in the Bureau's relevant market assessments. This is no doubt attributable to a recognition within the Bureau of the fact that although the absence of a significant correlation in the price movements of two products, or the presence of a significant absolute difference in prices, can generally be considered to be strong evidence in support of the proposition that the two products being compared are not in the same relevant market, the converse is not necessarily true. A significant price correlation may simply indicate that the products in question are responding to a third force such as the price of a common input or several common inputs. In short, proof of a price linkage or similarity at *current* conditions may provide little information about how sellers are *likely* to respond to, and whether sellers of the products being compared are likely to be able to *constrain*, a price increase or other exercise of market power in the future. A further limitation associated with relying on "price relationships" as a general framework of analysis is that Bureau staff are seldom able to obtain sufficient data about the true price at which products are actually sold, net of discounts and rebates, etc., to undertake a useful price comparison analysis within the limited time frames they have had for assessing a particular merger.

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[11] Cf. G. Werden, "Market Delineation and the Justice Department's Merger Guidelines," [1983] *Duke Law Journal* 514, at 573-4; Boyer, *ibid.*, at 94-5; D. Needham, "Substitutability Criteria for Market Definition," in Calvani and Siegfried, *ibid*, at 78; and R. Harris and T. Jorde, "Market Definition in the Merger Guidelines: Implications for Antitrust Enforcement," 71 *California Law Review* (1983) 464 at 472-3. Werden notes: "A monopolist contemplating a price increase cares about the proportionate amount by which the quantity demanded of its own product falls as price rises, which is indicated by the own-elasticity of demand. Cross-elasticities of demand indicate the proportionate amount by which the quantities demanded of other products change as the monopolist's price rises, but that is unimportant to the monopolist. Depending on the relative importance of the various products, given cross-elasticities may correspond to a wide range of own-elasticities. Similarly, cross-elasticities of demand indicate how the quantity demanded of the monopolist's product changes when the prices of other products change, but this knowledge also is irrelevant to the monopolist's decision. Furthermore, the magnitudes of the cross-elasticities between a product and each of its substitutes may not be nearly as important as the number of substitutes a product has. Many very small cross-elasticities may do more than one large cross-elasticity to keep a monopolist from increasing price."

[12] The "reasonable interchangeability" doctrine finds its roots in the following leading 1960s Warren Court decisions: *U.S. v. E.I. Dupont de Nemours & Co.*, 351 U.S. 377, at 395 (1956); *Brown Shoe Co. v. U.S.*, 370 U.S. 294, at 325 (1962); and *U.S. v. Continental Can. Co.*, 378 U.S. 441, at 453 and 465 (1964). The European Court of Justice employed the notion of "interchangeability" in the seminal *United Brands* decision, [1977-78] CCH Com. Mkt. Rep. (Court Decisions) p.7655, at 7705; and in the more recent *Michelin* case, [1983-85] CCH Com. Mkt. Rep. (Court Decisions) 14,488, at 14,510. See also the Berlin Court of Appeals decision in *Re GKN-Sachs Merger*, [1977] 1 C.M.L.R. D10 at §10.

[13] This contrasts with other approaches that employ price relationships as a *bona fide* paradigm of analysis. Cf. G. Stigler and R. Sherwin, "The Extent of the Market", *Journal of Law and Economics*, Vol.XXVIII (Oct. 1985), pp. 555-585. The "price relationships" approach, and the criticisms of it, are reviewed in the American Bar Association's (Antitrust Section) publication: *Horizontal Mergers: Law and Policy, Monograph 12* (1986), at 102-105. Weaknesses of this approach to relevant markets are discussed in greater detail in: Werden, *supra*, note 11, at 567-8; Harris & Jorde, *supra*, note 11, at 473; J. Ordover, and R. Willig, "The 1982 Department of Justice Merger Guidelines: An Economic Assessment," 71 *California Law Review* (1983) 535 at 551; and Abbott, A. "Foreign Competition and Relevant Market Definition Under the Department of Justice's Merger Guidelines," *Antitrust Bulletin*, (Summer 1985) 299 at 324.

2.3 Shipments Approach

Similar problems have been identified with respect to the "shipments approach",[14] pursuant to which the geographic bounds of a market are delineated by reference to the magnitude of shipments between regions.[15] The shortcoming that has been recognized to be associated with this approach is that although the existence or lack of existence of significant shipments between geographic areas can offer helpful information to assist in the delineation of the geographic scope of a relevant market, it cannot be relied on as conclusive evidence in this regard. This is because current shipment

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Scheffman and Spiller provide a unique conceptual aid for understanding the limitations of the usefulness of the price relationships approach by distinguishing between economic markets, which are based on arbitrage, and antitrust markets, which are artificial constructs that are created for the purpose of evaluating the nature of the constraints that would be faced by firms seeking to exercise market power. In certain types of situations, attempts by a seller in an economic market to raise price results in arbitrage which eliminates the newly created divergence between the actual prices or price spreads, to the point where historical similarities or relationships, but not necessarily former absolute price levels, are restored. In such situations, arbitrage tempers, but does not completely constrain, the exercise of market power. See Scheffman & Spiller, *supra*, note 8, at 124 *et seq*.

[14] This approach is advocated in K. Elzinga and T. Hogarty, "The Problem of Geographic Market Delineation in Antimerger Suits", 18 *Antitrust Bulletin* (1973). See also K. Elzinga, "Defining Geographic Market Boundaries", 26 *Antitrust Bulletin* (1981) 739. However, even Elzinga and Hogarty recognized the limitations of this approach, which Elzinga has characterized as one which is useful for "estimating only a minimum size" market. (*Ibid*, at 743).

[15] Elzinga and Hogarty proposed to delineate geographic markets by reference to whether 75% of the output of the plants located within the area are made within that area and 75% of the total sales made in the area are from plants located within the area. *Ibid*, at 73-4.

patterns may provide a misleading indication of the extent to which firms that do not actually ship between regions would likely do so in response to a price increase or other exercise of market power.[16] For example, the fact that imports have historically accounted for a small share of markets in which Canadian producers have always taken full advantage of the tariff protection that is afforded them, by pricing just below the level at which foreign products would flood the market, ignores the reality that they exercise an important constraint on the ability of domestic firms to further raise prices.

2.4 Direct and Immediate Effects Approach

Essentially the same shortcomings are associated with the "direct and immediate effects" approach that has been employed by the U.S. Supreme Court in several leading cases. Pursuant to this approach, the geographic market is "drawn narrowly to encompass the area where the 'effect of the merger on competition will be direct and immediate'," [17] i.e., "the market area in which the seller operates, and to which the purchaser can practicably turn for supplies."[18] By ignoring possibilities for product and geographic substitution on the supply side, this framework would usually define the relevant market too narrowly.

2.5 Hypothetical Monopolist

The "hypothetical monopolist" approach is described in the U.S. *Merger Guidelines* as follows:

> (T)he Department will begin with each product (narrowly defined) produced or sold by each merging firm and ask what would happen if a hypothetical monopolist of that product imposed a "small but significant and nontransitory" increase in price. If the price increase would cause so many buyers to shift to other products that a hypothetical monopolist would not find it profitable to impose such an increase in price, then the Department will add to the product group the product that is the next-best substitute for the merging firm's product and ask the same question again. This process will continue until a group of products is identified for which a hypothetical monopolist could profitably impose a "small but significant and nontransitory" increase in price. The Department generally will consider the relevant product market to be the smallest group of products that satisfies this test.[19]

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[16] Cf. Werden, *supra*, note 11, at 575-6; Abbott, *supra*, note 13, at 324-5; and Ordover & Willig, *supra*, note 13, at 551-2. See generally ABA, *supra*, note 13, at 100-101.

[17] *U.S. v. Philadelphia National Bank*, 374 U.S. 321, at 357 et seq, (1963). Cf. *U.S. v. Connecticut National Bank*, 418 U.S.656, at 668 (1974); and *U.S. v. Marine Bancorporation*, 418 U.S. 602, at 625-6 (1974).

[18] *U.S. v. Philadelphia National Bank, ibid*, at 359; and *Tampa Electric Co. v. Nashville Coal Co.*, 365 U.S. 320, at 327 (1961).

[19] *Supra*, note 9, at §2.11.

The U.S. *Guidelines* define geographic markets in the following similar terms:

> In defining the geographic market or markets affected by a merger, the Department will begin with the location of each merging firm (or each plant of a multiplant firm) and ask what would happen if a hypothetical monopolist of the relevant product at that point imposed a "small but significant and nontransitory" increase in price. If this increase in price would cause so many buyers to shift to products produced in other areas that a hypothetical monopolist producing or selling the relevant product at the merging firm's location would not find it profitable to impose such an increase in price, then the Department will add the location from which production is the next-best substitute for production at the merging firm's location and ask the same question again. This process will be repeated until the Department identifies an area in which a hypothetical monopolist could profitably impose a "small but significant and nontransitory" increase in price.[20]

The conceptual advantage of this approach is that it goes directly to the heart of the matter by delineating the smallest group of products and geographic area within which non-*de minimus* market power is exercisable. If the merger of all sellers of a given product in a given area would not facilitate the exercise of market power, then the merger of two firms can not. It is therefore only where a hypothetical monopolist would have the ability to exercise market power, e.g., by restricting output, raising price, reducing service or variety, or otherwise unilaterally influencing one or more dimensions of competition, that a concern can arise with respect to the ability of two firms in that market to behave in such a fashion.

On balance, Bureau assessment documents appear to have adopted a similar approach. However, as mentioned earlier, the formal steps that would be associated with employing a *bona fide* hypothetical monopolist methodology are seldom undertaken or considered necessary. This is largely attributable to the fact that mergers that have been considered to have had sufficiently serious potential implications to warrant the preparation of a detailed assessment document have been of the variety that raised concerns about dominant firm behaviour, i.e., the unilateral exercise of market power,[21] and have involved very thin markets where the identity of actual and potential competitors[22] has been readily ascertainable. This situation contrasts with that which appears to prevail in the U.S., where a relatively high proportion of the mergers that are seriously examined raise concerns about collusive behaviour in relevant markets that are often neither obvious nor easily delineated by reference to clear geographic regions and a product group that is accounted for by a number of firms that can be counted on one's fingers. In this context, the need to adopt a standard and formalistic approach to the identification of a minimum profitable ideal collusive group, within which to assess the likelihood of actual collusive behaviour, is much more compelling than has so far been the case in Canada.

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[20] *Ibid.*, at §2.31.

[21] The use of the notion "dominant firm behaviour' in this context should not be confused with the dominance definition in section 79 of the Act. Dominant firm behaviour, as employed here, simply means the unilateral exercise of market power, as opposed to the collusive variety of market power. Concerns can be raised about the likelihood of a merger conferring upon the merging parties the ability to unilaterally exercise market power, even though it is clear that the merged entity will not "substantially or completely control, through Canada or any area thereof, a class or species of business", as contemplated by ss.79(1)(a).

[22] As defined below in section 2.6.

2.6 Direct and Indirect Competition

The typical relevant market assessment in the Bureau begins with the product(s) and location(s) of each of the merging parties and attempts to identify the products and sales locations of firms that individually or collectively "directly" constrain the ability of each of these parties, respectively, to restrict output, raise price, reduce service or variety, etc., by a threshold amount premerger. As will be briefly discussed in section 2.8 below, the informal and flexible rule of thumb proxy for this threshold exercise of market power has usually been a 5% price increase. Firms identified at this stage can be those that exercise a constraining influence on the demand side, i.e.: (i) sellers of products (acceptable substitutes) currently available in the operating area of one or both of the merging parties, which would likely be purchased in significant quantities by customers of the merging parties in the event of a 5% price increase in the products of the latter; and (ii) sellers of acceptable substitutes who are located outside of this area, to whom customers of the merging parties would likely turn to make a significant percentage of their purchases in the event of a 5% price increase in the products of the latter; or firms that exercise a constraining influence on the supply side, i.e: (iii) sellers of acceptable substitutes who are located outside of this area, and who would divert a significant amount of such products into the operating area or areas of the merging parties, or into an area or areas from which customers of the merging parties would be prepared to purchase such output, in response to a 5% price increase in the products of the latter; and (iv) owners of production processes that would likely be adapted to commence the production of acceptable substitutes to be sold in the area or areas identified above, in response to a 5% price increase in the products of the latter.

Once all of the firms that "directly" compete with either or both of the merging parties, in the sense described above, have been identified, and once identification has been made of the geographic area or areas that bound(s) the locations of the merging parties and the other sales outlets to which a significant percentage of their customers would be prepared to travel to purchase acceptable substitutes in the event of a 5% price increase, an attempt has then been made to identify whether there are additional sellers that "indirectly" constrain the ability of the respective merging parties to impose this price increase. This exercise would appear to have been pursued in recognition of the fact that a competitive environment is often broader than just the products and outlets of the merging parties plus the products and outlets of those firms identified above that directly constrain the former. There is typically a complex system of indirect sources of competition that also must be included in the market, because such sources constrain, or even indirectly constrain, the firms that directly constrain the entities seeking to merge.[23] Stated alternatively, if the presence of these sources of constraints prevents the exercise of the threshold degree of market power with respect to the group of products and area identified above, then to ignore such competition would seriously overstate the market position of the merging parties and, possibly, erroneously suggest the presence of conditions that might be conducive to anticompetitive behaviour. By contrast, if all or some of the identified sources of "indirect" competition do not appear to be responsible for the inability of the respective merging parties to profitably increase prices by the threshold amount premerger, then the inclusion of such sources of competition in the relevant market would render it too broad.[24]

Accordingly, an attempt has generally been made to identify all sources of competition which are "indirect" from the perspective of the respective merging firms, and which appear to play a significant role in constraining the ability of the already identified sellers to impose a 5% price increase with respect to the product(s) and area(s) in question. When such indirect sources of competition have been identified, the products of these competitors and the locations from which they are sold have been added to the previously identified group of products and locations. This addition of products and sales locations has generally continued until there no longer appeared to be any further sources of competition that could be said to constrain the ability of the identified sellers to profitably impose a 5% price increase over a significant part of the area(s) in which they operate and group(s) of products that they sell, for a threshold time period. The word "significant" is key because markets often overlap, particularly with respect to the geographic dimension, but not to an extent that would warrant a conclusion that the firms that compete in an adjacent market constrain the ability of the firms in the market(s) in which the merging parties compete to profitably impose a 5% price increase across the greater part of the latter market(s). For example, the fact that a small amount of milk or beer flows across the Ottawa River between Quebec and Ontario at points such as Ottawa-Hull, Hawksbury and the intersection of the highways 401 and 20 does not compel a conclusion that the geographic market for milk or beer is Ontario and Quebec combined. By contrast, in the assessment of the Texaco/Imperial Oil merger the extent to which refined gasoline moves or could move between these two provinces by truck, pipeline and ship was considered to be of sufficient magnitude to warrant treating them as one geographic market, largely separated from other regions of Canada by transportation costs.[25]

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[23] Werden, *supra*, note 11, at 560, has succinctly articulated the point as follows: "...firms need not be direct competitors to be in the same market. There are two reasons for this. First, the relevant competition is with the merging firm that occupies the center of the circle. In many cases, the distance, in geographic space or in other dimensions, between two sellers in a market will be greater than the distance between the firm in the center and any other firm. Second, the outermost firms in a market generally will not compete directly with the firm in the center."

[24] Where the inclusion of these latter sources of competition in the relevant market would not significantly affect the assessment of the merger, the Bureau has often simply included them in the market in order to focus on more critical issues.

If, at the end of the foregoing exercise, the merging parties have been found to be in separate relevant markets, then absent a potential competition or barriers to entry[26] argument, Bureau staff have typically recommended that the transaction be permitted to proceed without challenge.

2.7 Relevance of Other Factors

Notwithstanding the fact that the foregoing procedure should identify all readily ascertainable sources of actual and potential competition that will likely respond to the threshold exercise of market power, the nature and extent of barriers to entry and foreign competition, together with the availability of acceptable substitutes, are considered to have independent relevance as evaluative criteria[27] once the relevant market has been defined. This is so for a number of reasons.[28] The most important is that it is virtually impossible, particularly with respect to markets that are becoming increasingly globalized, to identify all firms that would likely react to a given price change. A second consideration is that expansion by firms within the market, especially fringe firms, is a form of "entry", and it is important to know whether there exist any impediments to such expansion. In addition, there are often good reasons for leaving particular types of potential competitors outside of the relevant market. For example, U.S. firms frequently indicate that they are simply not interested in taking the time and trouble to sell products in Canada, and would not be enticed to change their mind by a 5% price increase. Reasons given for this position include the "hassle" factor associated with getting products across the border and procuring licences, etc., volatile exchange rates, and even an acknowledged ignorance about the nature of the Canadian market. Other situations where a potential competitor has been left out of the market and considered instead in connection with likelihood of future entry, after the market has been defined, include where a particular firm would have to invest in significant modification of existing production facilities, in order to commence production of an acceptable substitute, or construct new facilities within the relevant market.[29] With respect to acceptable substitutes, their principle independent relevance as an evaluative criteria lies in the fact that their mere inclusion in the relevant market says very little about the extent to which they would likely be available (i.e., could be sold in increased quantities), in the event of the threshold price increase. It is also important to determine the nature and extent of barriers to entry and foreign competition, together with the availability of acceptable substitutes, in evaluating the extent to which competition is likely to be lessened, for the purposes of the section 96 balancing assessment.

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[25] DIR v. Imperial Oil Limited, Statement of Grounds for Application, dated June 29, 1989, at §53.

[26] For example, a vertical merger can increase barriers to entry into one or both of the markets of the merging parties, thereby increasing the scope for anticompetitive behaviour. See generally, P. Areeda and D. Turner, *Antitrust Law* (Boston: Little, Brown & Co., 1980), at 1011 *et seq*; Ordover & Willig, *supra*, note 13, at 569 *et seq.*; and American Bar Association, Section of Antitrust Law, *Non-Horizontal Mergers: Law and Policy* (Monograph 14), 1988, at 57 *et seq.* See generally Crampton, *supra*, note 1, at Chapter 6, section 11.

[27] Note that these considerations are specifically mentioned in subsection 93(d), (a), and (c), respectively.

[28] See generally Crampton, *supra*, note 1, at Chapter 6, sections 3, 5 and 6.

It is important to recognize that it is the output or capacity[30] of the firms identified pursuant to the foregoing exercise, and not the firms themselves, that have been included in the relevant market. This distinction is important because some of the firms identified pursuant to the foregoing exercise are located in distant areas and sell only a fraction of their output in the relevant market area through sales outlets situated therein. As will be discussed in greater detail below, in such cases it has generally been considered to be appropriate to include less than the entire output or capacity of these firms in the relevant market when calculating market shares.

The hypothesized price increase must be capable of being profitably imposed because there is no point in confining the relevant market to a particular inelastic segment if the customers in this segment cannot be identified *and* be subjected to price discrimination or other exercise of market power confined to them alone. For example, with respect to the Wilkinson Sword acquisition of D.D. Bean & Sons, the Bureau recognized that there was probably a "hard core" segment of match users whose demand for matches was particularly inelastic. However, as a result of a determination that matches are sold in a larger "lights" market, in which match producers compete vigorously with sellers of lighters, particularly low-end disposable lighters, and given that it is not possible for match sellers to identify the segment of their customers who would likely be prepared to pay a significantly higher price for matches rather than switch to a lighter, it could safely be assumed that the merged entity would not risk losing the majority of its sales to lighter

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[29] A similar position is taken in this regard in the U.S. 1984 Merger Guidelines, *supra*, note 9, at §2.21.

[30] Cf. discussion below in section 2.9.

manufacturers in order to extract greater profits from their inelastic customers. In short, it would not have been a profitable strategy to pursue, and therefore there was no need to confine the analysis to this segment of the market.

By contrast, in situations where it would have been possible for the merging parties to identify one or more inelastic segments and subject them to a price increase that does not contravene the price discrimination provisions of the Act,[31] Bureau practice has generally been to recognize (a) distinct relevant market(s) within the broader relevant market that will have been identified pursuant to the above exercise. These relevant markets should not be confused with submarkets, which are simply product or geographic segments within a single relevant market that display unique characteristics with respect to which anticompetitive effects may be possible in the short run but not over the threshold time period, due to the competitive dynamics at work in the rest of the relevant market.[32]

2.8 Threshold Price Increase

It would appear that the Bureau has generally assessed relevant markets by reference to a threshold price increase, as opposed to a similar increase in profits, largely out of necessity. Although there has been some recognition within the Bureau of certain theoretical advantages associated with employing a profit standard,[33] practical constraints such as the restricted time frame within which mergers must be reviewed and the Bureau's resource limitations have deprived officers of the luxury of choice. Given that the jury appears to be still out on whether profit is superior to price as a *general standard* for the purpose of measuring market power,[34] it is by no means clear that the Bureau's analysis has suffered as a result of this practice.

The "price" that has typically been employed within the Bureau in this regard is the "cumulative price", i.e., the total value of the product when it leaves the stage of the industry in question.[35] This simply represents the sum of input costs plus the value added. Alternative "prices" that have been considered are the "final price",[36] i.e., the price paid at the point of final consumption, and the "value added price",[37] i.e., the difference between the cost of all inputs and the cumulative price. Consider for example a merger between fruit importers. The price that would likely be employed is the price at which the fruit imported by these parties, i.e., watermelons, oranges, bananas, etc., is sold to food wholesalers ("cumulative price"). This contrasts with the price at which consumers ultimately purchase these products from retailers ("final price"), and the markup that the importers charge for their importing functions, i.e., the price invoiced to wholesalers less the cost of the watermelons at point of entry into Canada ("value added"). Situations where this "value added" is billed as a separate fee, *and* where no markup is applied to the product in relation to which the service is performed, have been considered to present special analytical and practical difficulties that may warrant treating the fee, rather than the sum of the amounts invoiced for the fee and the product, as the price.[38] Of course, the "cumulative price" for the retailer is also the "final price".

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[31] For example, given that s.50(1) only prohibits discrimination with respect to "articles" of like quality and quantity, prices can be raised to purchasers of custom-made products and to smaller purchasers who may not be able to economically access sources of supply in other areas. Note also that the definition of "article" does not include a "service". Cf. discussion of Domglass/Consumers Packaging, *infra*, section 4.1.

[32] See generally Crampton, *supra*, note 1, at p.289 *et seq*, for a more detailed discussion of this matter and the criticism that has been directed at the U.S. Supreme Court's treatment of submarkets.

[33] Cf. Harris & Jorde, *supra*, note 11, at 482; and ABA, *supra*, note 13, at 121. See also L. Schwartz, "The New Merger Guidelines: Guide of Governmental Discretion and Private Counseling or Propaganda for Revision of the Antitrust Laws?" 71 *California Law Review* (1983) 575 at 585.

[34] Cf. Ordover & Willig, *supra*, note 13, at 540; Baker, T. "The 1984 Justice Department Guidelines", 53 *Antitrust Law Journal* (1987) 327, at 329.

In cases where it has appeared that a merger would likely to lead to a significant increase in the cumulative price but would not likely lead to a significant increase in the final price,[39] this fact has usually been taken into account in deciding whether to challenge the transaction. The same would appear to be true where it has been concluded that an increase in the price of an intermediate product would not likely translate into an increase in the price of the product in which the intermediate product is embodied. For example, in Nova/Polysar, an important factor in the staff recommendation not to challenge was that downstream petrochemical derivative markets in which ethylene feedstock products compete are highly competitive, and would not likely permit sellers of the latter to increase prices.[40]

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[35] See generally Werden, *supra*, note 11, at 536 *et seq.*.

[36] *Ibid*, at 537 *et seq.* Cf. note 39 *infra*.

[37] *Ibid*, at 535 *et seq.* Cf. Levy, "Measuring the Price Increase in Merger Cases: Five Percent of What?" 2 A.T.R.S. Rep. 4 (Spring, 1989).

[38] In these situations, the U.S. Merger Guidelines indicate that the DOJ will consider the fee to be the price. See *supra*, note 9, at §2.11: "the price for which an increase will be postulated will be whatever is considered to be the price of the product at the stage of the industry being examined." The example given is tariffs charged by oil pipelines. (However, note that these Guidelines also indicate that if the "price" to be increased is a tariff or commission that constitutes a small fraction of the price of the product being transported or sold, an increase of greater than 5% price increase may be employed as the appropriate benchmark). The difficulties associated with employing this approach as a general rule are discussed in Werden, *supra*, note 11, at 534-5.

[39] An increase in cumulative price will not translate into an increase in final price where, for example, a price increase to a wholesaler cannot be passed on to the final buyer due to the latter's countervailing power. The determination of the identity of the "final buyer" is largely one of common sense. For example, the "final buyer" of industrial milk would not be considered to be the consumer who purchases ice cream or yogurt, but the company that uses the industrial milk to make these products.

It would appear that a 5% threshold is typically employed in Mergers Branch assessment documents, as opposed to, say, a 2% or a 10% standard, because it has been considered to be the threshold that is most likely to minimize the sum of Type 1 and Type 2 errors[41] associated with reviewing the kinds of mergers that arise in the Canadian economy. As indicated earlier, the majority of mergers that have been considered to have had sufficiently serious implications to warrant the preparation of an assessment document have been those that raised concerns about dominant firm behaviour. In this context, it seems that a higher standard, e.g., 10%, has not been considered to be as appropriate *qua* flexible rule of thumb as it might be in the U.S.,[42] where the majority of cases that attract close scrutiny are those that raise concerns about collusion, which is rarely perfect,[43] and which is less likely to be encouraged by the prospects of a "mere" 5% price increase, given the various costs associated with collusive activity.[44] These costs are even greater in the U.S. than in Canada, because of the higher conviction rate for collusive behaviour that has been challenged pursuant to the conspiracy provisions of §1 of the *Sherman Act*, the higher criminal penalties that have been imposed, the prospect of treble damages in civil suits, and the fact that corporate executives have been put in U.S. jails for this conduct.[45] In addition, given that the *Competition Act* has an explicit efficiency gains provision, there is less need to build into the threshold that is selected a particular margin of error to reduce the likelihood that mergers that are likely to generate net economic gains for society will be challenged.

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[40] Cf. Consumer and Corporate Affairs Canada, NR-10082, May 5, 1988, p.3.

[41] A Type 1 error occurs when a merger that would not contravene the Act, and can therefore be assumed to be likely to be beneficial for the economy, is blocked or abandoned as a result of a position taken by enforcement authorities. A Type 2 error occurs where a merger that contravenes the Act, i.e., is likely to confer upon the merging parties an ability to exercise increased or *de novo* market power, is permitted to proceed unchallenged. See generally A. Fisher and R. Lande, "Efficiency Considerations in Merger Enforcement," 71 *California Law Review* (1983) 1580, at 1670 *et seq*. As the threshold that is employed to define markets is increased, the scope for Type 2 error increases; and as this threshold is decreased, the scope for Type 1 errors is increased.

[42] Although the 1984 *U.S. Merger Guidelines*, *supra*, note 9, at §2.11, indicate that the DOJ employs a 5% price increase as the threshold "in most contexts", it is apparently "generally known that the Department now focuses on increases of ten percent or greater." J. DeQ. Briggs, "An Overview of Current Law and Policy Relating to Mergers and Acquisitions," [56] *Antitrust Law Journal* (1988) 657, at 681 n.1. See also T. Krattenmaker and R. Pitofsky, "Antitrust Merger Policy and the Reagan Administration," *Antitrust Bulletin* (Summer 1988) 211, at 226. This is the threshold that was favoured by DOJ economists at the time the Merger Guidelines were drafted. L. White, "Antitrust and Merger Policy: A Review and Critique" 1 *Journal of Economic Perspectives* (Fall 1987) 13, at 15.

Notwithstanding the presence of particular conditions in the U.S. which might warrant raising the threshold to 10%, a 5% threshold for market definition appears to enjoy broad support in the U.S.. See for example: F. Fisher, "Horizontal Mergers: Triage and Treatment", 1 *Journal of Economic Perspective* (Fall 1987) 23, at 30; R. Schmalensee, "Horizontal Merger Policy: Problems and Changes," 1 *Journal of Economic Perspective* (Fall 1987), 41, at 49; Abbott, *supra*, note 13, at 309; and Werden, *supra*, note 11, at 550.

[43] Werden, *supra*, note 11, at 546. This observation applies *a fortiori* in an economy with "deep" markets.

It would appear that a lower than 5% threshold has not generally been employed due to the difficulty associated with determining whether data that may be available with respect to price movements of a few percentage points is evidence of inelasticity or is attributable to "noise" created by one or more of a number of unascertainable factors. Moreover, because customers and actual or potential competitors in most industries often (erroneously and irrationally) indicate that they would not likely switch to another product or source of supply, divert production from one area to another, alter production processes, etc., in response to a price increase of only a few percentage points, unrealistically narrow markets would be yielded if a less than a 5% threshold were employed in the average case. Nevertheless, in recognition of the view that a less than 5% threshold may in certain situations be warranted, for example in assessing low margin-high profit-high turnover industries,[46] there is a general awareness in the Bureau that the 5% rule of thumb is just that, and can be lowered in appropriate cases. In this regard, case officers, like their counterparts in the U.S., seem to make their decisions "on the basis of what might be called informed intuition".[47]

Before turning from the subject of price thresholds, it is pertinent to note that Bureau staff have generally employed actual prices, rather than theoretical "competitive prices". However, in doing so, they have been keenly aware of the well-known pitfalls of the *Cellophane* trap,[48] which refers to the situation where market power has been already exercised up to the point where poor substitutes would be purchased in the event of a further price increase, thereby suggesting that the latter should be included in the relevant market if actual prices are employed. In short, Bureau staff do not appear to have considered that this potential problem requires dedicating an inordinate amount of resources to attempt to determine the "competitive prices" that would exist if the firms in question were subject to a high degree of discipline from existing or potential producers of good substitutes. In view of the fact that the merger provisions of the *Competition Act* proscribe transactions which are likely to "prevent or lessen" competition, an actual price standard seems to have been considered to have been sufficient where it appeared that market power would be increased, and a future price standard[49] seems to have been considered adequate where it appeared that market power which would otherwise be eroded or partially eroded "but for" the merger was likely to be entrenched. In this latter regard, the approach appears to have been that if Bureau staff have believed that a merger was pre-emptive in nature and was likely to prevent a significant price reduction with respect to a product or group of products in a particular geographic area, they have attempted to determine whether the percentage difference between what would likely have been the price in the absence of the merger and the actual price was equal to or greater than the threshold amount, e.g., 5%. Where the merger has been believed to be likely to lead to such price effects, the relevant market has been delineated on the basis of what good judgment suggested was the market over which market power had already been exercised.

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[44] Cf. *ibid*, at 538.

[45] Cf. C. Rule, "Antitrust, Consumers and Small Business" (Remarks made at the 21st New England Antitrust Conference, Harvard Law School, Nov. 13, 1987). At p.10, Mr. Rule, then Assistant Attorney General, Antitrust Division, DOJ, observed: "In the past year alone (fiscal 1987), we brought 92 criminal prosecutions, primarily for price fixing and bid-rigging; we obtained 114 convictions of individuals and corporations, we imposed almost 18 million dollars (U.S.) in fines, and we put individual defendants in jail for a total of 1,994 days."

[46] Cf. Schwartz, *supra*, note 33, at 585; and B. Clark, "Merger Investigations at the Federal Trade Commission: An Insider's View," 56 *Antitrust Law Journal* (1987) 765, at 772-3, citing the example of a supermarket merger. See also Harris & Jorde, *supra*, note 11, at 482; and Baker, *supra*, note 34, at 329.

[47] Baker, *supra*, note 34 at 328.

2.9 Market Shares

Once the relevant market has been defined, attention has been turned to calculating market shares and assessing various other evaluative criteria such as the factors that are set forth in section 93 of the Act. A discussion of these latter criteria is beyond the scope of this paper. Market shares have typically been measured in terms of either dollar sales or unit output. However, it is recognized that dollar sales can be misleading indices of overall market position where significant price disparities attributable to product differentiation exist within the market. For example, in *Carling O'Keefe/Molsons*, where premium and discount beers were included within the same relevant market as regular priced beer, the Bureau employed unit (rather than dollar) sales as the appropriate benchmark.

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[48] This refers to a famous U.S. monopoly case involving a cellophane producer in which the relevant market was found to be flexible packaging materials, on the basis of evidence of a high degree of interchangeability and price sensitivity between cellophane and other wrapping materials at prevailing prices. *U.S. v. E.I. DuPont De Nemours & Co.*, 351 U.S. 377, at 394-404 (1956). This finding is considered by many to have been erroneous, on the ground that the court focussed its attention solely on whether DuPont could exercise further market power, without considering the whether it had already exercised market power to the point where poor substitutes had become attractive alternatives. See generally ABA, *supra*, note 13, at 124 *et seq.* For the most noted criticism of this judgment, see Gene C. Schaer, C. "The Cellophane Fallacy and the Justice Department's Guidelines for Horizontal Mergers", 94 *Yale Law Journal*, (1985) 670 at 677. By contrast, for an endorsement of the general approach employed in the Mergers Branch, see Werden, *supra*, note 11, at 526; and W. Baxter, "Responding to the Reaction: The Draftsman's View," 71 *California Law Review* (1983) 618, at 624 n.35. See also R. Posner, *Antitrust Law: An Economic Perspective* (Chicago: University of Chicago Press, 1976), at 128-9.

[49] This would simply require an estimation of what the price would likely have been if the merger had not taken place.

Generally speaking, where products within a market are relatively homogeneous, measurements based on unit sales should not differ significantly from calculations based on dollar sales. Therefore, the choice has typically been made based on which type of data has been more readily available. Alternative methods of measurement that have been employed in relation to homogeneous product markets are production capacity and reserves. For example, in *Texaco/Imperial Oil* concentration ratios were expressed in terms of both unit output and refining capacity.[50] Similarly, in *Gemini*, market shares were expressed in terms of both flight segments booked on airline computer reservations systems and the number of computer reservation terminals (CRTs) in travel agencies.[51] The Tribunal discussed market shares in that case in terms of both of these measures, which it indicated were more "useful" measures than the number of travel agent locations in which one or more CRTs were located, which was a third alternative that had been suggested.[52]

However, there has been some recognition that special care should be taken when relying on capacity figures, because capacity may be committed under long term contracts, reserved for consumption within vertically integrated firms, or costly to bring on stream. In such cases, it has usually been considered appropriate to include within the market only the amount of capacity *likely* to be diverted into the relevant market in response to the threshold price increase, within the appropriate time period. For example, in *Palm Diaries*, the Bureau adjusted market share figures based on production data to reflect the fact that two processors sold 95% and 65%, respectively, of their capacity to affiliated retailers, and would likely continue to do so even if prices of "competitors'" products significantly increased.[53] In the case of capacity committed under long term contracts, an alternative approach has simply been to discount the significance of market shares yielded pursuant to a calculation of the absolute capacities or output of market participants. This approach is considered by some to be more conceptually appropriate because the product has actually been sold in the market.

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[50] Supra, note 19, at pp. 55 and 56.

[51] DIR v. Air Canada et al, (Application, dated March 3, 1988, at §§25-28).

[52] DIR v. Air Canada et al, CT-88/1, "Reasons for Consent Order," July 7, 1989, p. 11 (1989) 27 C.P.R. (3d) 476.

[53] DIR v. Palm Dairies et al, CT-1-86, Affidavit of D. Wolinsky submitted on behalf of the Director, dated Sept. 3, 1986, at p.12.

Similar problems of market share measurement have arisen in connection with markets that include products of firms located outside of the relevant geographic area. It has been argued that "if a distant seller has made some sales in a local market, *all* its sales, wherever made, should be considered a part of that local market for the purposes of computing the market share of a local seller."[54] This approach does not appear to have been well received in the Bureau, primarily because it fails to recognize that it may not be profitable for the distant seller to divert all production to the local market in response to the threshold price increase,[55] and because all of the output of a distant seller may not be available for diversion to the local market in question. For example, firms may have long term supply contracts or less formal business and community relationships that would be costly to break from a short run or a long run point of view.[56] With these considerations in mind, the practice within the Bureau appears to have been to include only the amount of production *likely* to be diverted to the relevant market in response to the postulated price increase.

The situation in this regard is somewhat more complicated when the distant producer is located in the U.S. or some other foreign nation. Although the general principal that only the amount likely to be diverted has apparently still been applied, significant difficulties have been encountered in attempting to evaluate what is likely to happen, given the presence of one or more of a variety[57] of impediments, such as: exchange rate fluctuations; a reluctance on the part of domestic purchasers to source from, or non-Canadian suppliers to supply into, a foreign location; uncertainties regarding border delays and the collection of goods or payment; the threat of an antidumping action, etc. In consumer products markets, additional difficulties have been presented where foreign goods have been differentiated, due to the need to assess the extent to which the incentives to increase supply that are provided by a significant price increase are undermined by the profitability of maintaining a particular product niche strategy.[58] Where any of these types of considerations have made it difficult to ascertain the magnitude of production that would likely be diverted in response to the postulated price increase, only the current shares, if any, have generally been employed. The prospect for increased sales has then generally been given appropriate weight in the assessment of foreign competition and barriers to entry pursuant to section 93, with due regard being had to import quotas, etc.[59]

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[54] Landes & Posner, *supra*, note 6, at 963. Cf. P. Areeda and D. Turner, *Antitrust Law* (Toronto: Little, Brown and Company, 1986), (vol. 2), at §523b, where it is suggested that the entire output of the distant producer should only be included where local price exceeds the remote price by at least the amount of transportation costs.

[55] Cf. P. Areeda, "Market Definition and Horizontal Restraints," 52 *Antitrust Law Journal* (1983) 553, at 575 and 579.

[56] Cf. Harris & Jorde, *supra*, note 11, at 480-1; and Schwartz, *supra*, note 33, at 585. See also Ordover & Willig, *supra*, note 13, at 546-7; and Schmalensee, *supra*, note 42, at 50.

[57] Cf. Crampton, *supra*, note 1, at Chapter 6, section 3.

Parenthetically, there is no inconsistency between limiting the application of the Act to transactions (or other behaviour) that have an effect within Canada, and allowing for the possibility that the geographic extent of a market may be larger than Canada. This can be illustrated by considering the case of a merger between the last two widget makers in North America, each of whom happen[60] to be located within Canada. Assuming that there are no transportation, regulatory or other barriers that would make price discrimination possible in particular regions of the continent, and assuming that there are legitimate grounds for not expanding the dimensions of the market beyond North America, the relevant market could legitimately be characterized as North America, and the jurisdiction of the Director and the Competition Tribunal would be triggered by the anticompetitive effect that occurs in the Canadian part of the market.

A final matter that should be addressed before turning to the next section concerns the threshold time period that is considered by the Bureau in assessing likely demand and supply responses. The U.S. *Merger Guidelines* adopt a one year period in this regard.[61] It would appear that Bureau staff have considered this to be too short a time period in situations such as where markets are characterized by infrequent sales or by contractual arrangements that are typically longer than one year. Accordingly, in view of the fact that there is no point in working with a time period within which market power is not likely to be exercised, a time period that more appropriately reflects a likelihood that market power will be exercised appears to have been adopted in such cases.

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[58] Cf. Abbott, *supra*, note 13, at 321.

[59] Note that Landes and Posner excepted from their general rule the case where distant sellers do not have significant sales in the market. See *supra*, note 6, at 967, and text corresponding to note 54 above. Similarly, Abbott, who advocates generous treatment of foreign competition in market share computation, suggests that where imports are totally absent from the domestic market, a rebuttable presumption should arise that such competition not be included in the relevant market. See *supra*, note 13, at 330 and 316.

[60] Of course, both parties would not need to be located in Canada before the Tribunal would have the jurisdiction to issue a meaningful remedial order.

[61] Supra, note 9, at §§2.11, 2.21 and 2.31.

3.0 FACTUAL CRITERIA THAT HAVE BEEN TAKEN INTO ACCOUNT

In determining the factual bounds of a relevant market in a particular case, the Bureau has typically assessed a wide variety of factors. Although certain of these factors may have suggested that the bounds of the market should have been broader or narrower than those ultimately adopted, a thorough assessment has generally yielded a result that, in the Bureau's view, clearly pointed in one direction. Obviously, merging parties may have had legitimate grounds for believing that the evidence pointed in a different direction, and were free to pursue the matter before the Tribunal if they considered the Director's reasons for concluding that the merger contravened the Act to have been highly sensitive to the relevant market definition.

On the demand side, as indicated earlier, evidence relating to cross-elasticities; the extent to which products are substitutable or reasonably interchangeable in end use; and the extent to which prices are correlated and/or are different, has been very persuasive in many cases.[62] An equally if not more important source of evidence has been what buyers think. In short, where buyers have indicated that they would not substitute product A for product B in the event of a significant price increase or other exercise of market power with respect to product B, then it has generally been considered to be very difficult to justify placing products A and B in the same market on the basis of theoretical arguments. Other factors that have been considered relevant to assess from the demand side are actual buyer behaviour; differences in product characteristics or images; differences in the "bundle" of services, etc., that are provided with, or in relation to the product;[63] and the similarity or dissimilarity between buyers.

On the supply side, evidence with respect to the following has generally been sought: the ease with which producers of one product can switch to the production of the product(s) sold by the merging parties; trade opinion and behaviour; the role of regulatory and other barriers; whether similar distribution channels are used; the nature of particular production processes that are used by the companies whose products are being assessed; and the role of second hand and reconditioned products.

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[62] Note that in the recent Chrysler case, *supra*, note 1, auto parts sold by Chrysler Canada Ltd. were found to constitute a distinct market from identical auto parts sold by Chrysler's U.S. parent, primarily because the prices charged in the two countries were significantly different.

[63] For example, in Chrysler, *supra*, note 1, the Tribunal took note of the following benefits associated with ordering auto parts in Canada relative to ordering them from the U.S: "price protection" against changes in prices between the time of order and delivery; Chrysler Canada provided an "availability report" which identified the parts that were immediately available and the length of the delay that would be required in supplying each of the remaining parts; a higher percentage of "immediately filled" orders; the balance of orders were filled more quickly; and the accuracy with which orders were filled was higher in Canada than in the U.S.. On the product side, the Tribunal excluded from the market auto parts sold in large quantities as part of a special program for the following reasons: very large minimum purchase requirements; orders had to be placed in advance for later manufacture and hence it might take considerable time for an order to be filled; parts were packaged in bulk rather than individually; prices were much lower than for parts ordered in small volumes.

In the assessment of the geographic scope of markets, additional considerations that are generally taken into account include shipment and purchase patterns; transportation costs; buyer convenience; the time required to transact with more distant suppliers; the inherent characteristics of products that render transportation over long distances problematic; costs associated with local set up; and the presence of excess capacity.

4.0 RELEVANT MARKET ANALYSIS IN SPECIFIC CASES

4.1 Domglas/Consumers Packaging

This transaction concerned the acquisition of all of the assets of Domglas Inc. by Consumers Packaging Inc..[64] Domglas and Consumers were the last two significant manufacturers of food and beverage glass containers in Canada. The central relevant market issue that arose in this case was whether the product dimension should be confined to glass or expanded to include all "rigid wall containers" manufactured for the food and beverage industry. Analysis by the Bureau led to the endorsement of this latter view of the market with respect to a large segment of the products sold by the merging parties, on the basis of evidence which indicated that intermaterial competition between glass containers, on one hand, and rigid wall plastic, paperboard, aluminum and steel containers, on the other hand, was extremely intense, dynamic and continuing to intensify with technological innovation. For example, it was determined that plastic containers have made considerable inroads in the soft drink, peanut butter, edible oil and condiments (e.g., ketchup) product segments; metal cans have made large inroads with respect to single-serving size soft drinks; and paperboard cartons and plastic have almost entirely replaced glass bottles in the milk industry. In the larger rigid wall packaging market, the Bureau estimated that the merged entity would have less than a 20% market share.

With respect to customers who purchase for these and other end uses, it was clear that the market power of the merged entity would be virtually completely constrained by the ability of these buyers to switch to one or more alternate packaging materials, sold in Canada or the U.S., in the event of a 5% price increase. However, this was not considered to be the case with respect to certain other buyers, whose demand for glass containers was found to be relatively inelastic. In particular, the Bureau determined that purchasers of glass for the following six end uses would not likely change to an alternate rigid wall packaging material in the event of a 5% price increase: distilled spirits, beer, wine, pickles, mayonnaise and soluble coffee. For buyers of these products, the particular properties of glass, such as its impermeability to oxygen, its ability to withstand high temperature filling processes, its transparency, its recyclability, its ability to be heated in microwave ovens, its role in brand image, and the reclosable nature of most glass products, were such as to render other packaging materials poor end use substitutes. In addition, many of these buyers indicated that significant production and marketing costs would be associated with switching from glass to another material.

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[64] Cf. Consumer and Corporate Affairs Canada, NR-10188, April 25, 1989; *Canadian Competition Policy Record*, Vol. 10(2), 1989, pp. 11-12.

On the basis of the foregoing, glass, rather than rigid walls, was concluded to be the appropriate product dimension of the relevant market for products purchased by these buyers. In this regard, the market was limited to the products of Domglas, Consumers and certain U.S. glass producers, on the basis of evidence which suggested that producers of non-glass rigid wall containers would not find it profitable to alter their production processes to commence the production of glass containers in response to a 5% price increase in the glass products in question. With respect to the geographic dimension, it was determined that many of the buyers of glass products in these inelastic product segments ordered sufficient quantities to be able to source supply from one or more of eight U.S. glass plants located within 300 miles of the Canadian border. That is to say, for these buyers the cost savings associated with making large orders from U.S. suppliers, relative to purchasing from the merging parties at a 5% markup over premerger prices, would likely offset the transportation costs and the 11.4% import duty. While these purchasers had rarely or never sourced product from the U.S., with the exception of beer bottles, they considered U.S. suppliers to be a viable alternative to whom they would not hesitate to turn in the event of a 5% price increase.

However, there were buyers in each of the inelastic product segments that were too small to obtain competitively priced supply in the U.S., either because sufficient cost savings were simply not available to offset the combined effect of transportation costs plus the import duty, or because of a reluctance on the part of U.S. firms to retool and halt long production runs for the purpose of producing a small order. In view of the fact that these buyers accounted for a significant percentage of the merging parties' sales, it was not considered to be appropriate to extend the geographic dimension of the relevant market for these inelastic product segments beyond the Canada/U.S. border. Given that Consumers and Domglas competed for sales across Canada, had plants located across the country, sold to customers nationwide, quoted prices on a national basis, and often shipped product over much greater distances than the generally acknowledged 300 mile "freight logical zone", the geographic scope of the relevant market was considered to comprise all of Canada.

On the basis of the foregoing analysis, it was apparent that the merger would transform a competitive duopoly into a virtual monopoly with respect to a significant group of buyers in the aforementioned six inelastic segments. Nevertheless, in view of the following considerations, the merger was permitted to proceed unchallenged, but subject to a three year monitoring program: (i) U.S. supply alternatives were considered to be likely to become increasingly attractive as U.S. firms continue to reduce their costs and as the import duty is phased out under the Free Trade Agreement, (FTA); (ii) purchasers in the inelastic segments could source competitively priced supply in the U.S. if they were willing to switch from custom made to "stock" glass containers; (iii) the parties to the merger assured these customers access to long-term supply of glass containers at equitable terms and conditions; (iv) several of these customers had countervailing power by virtue of the size of their purchases of other glass products from the merging parties; (v) prices charged to these latter customers in relation to their small orders of inelastic products would make price discrimination more difficult with respect to the products ordered by many of the remaining customers in the six product segments in question; (vi) the parties formally applied to eliminate the tariff on U.S. imports over a five-year period, rather than the ten year period provided for under the FTA; and (vii) the merger would be procompetitive with respect to the manufacture of glass containers that were part of the larger "rigid wall container" market, due to the fact that efficiency gains that were likely to flow from the merger would enable the merging parties to better compete against U.S. rigid wall container suppliers.

4.2 Eddy/Scott

This transaction involved the acquisition by Scott Paper Limited of the Sanitary Tissue Division of E.B. Eddy Forest Products Limited.[65] At the time of the merger, Scott was engaged throughout Canada in the manufacture and sale of sanitary tissue products, which include bathroom tissue, paper towels, facial tissue, paper napkins and other tissue products. It also manufactured adult incontinence products through its joint venture company, Sancella Incorporated. Its plants were located at New Westminster, B.C., and at Crabtree and Lennoxville, Quebec. Eddy produced similar sanitary products at one of its Hull, Quebec sites, which it sold primarily in Eastern Canada. It was also involved in the production of pulp, lumber and fine and specialty papers.

The principal relevant market issue that arose on the product side in the review of this merger related to whether each of the tissue products in question constituted a distinct relevant market or whether there was a single "sanitary tissue products" market, as a result of supply side substitutability in relation to these products. In short, the Bureau ultimately adopted an intermediate position after it was confirmed that converting processes, in which various tissue products are made from large "parent rolls" of raw tissue, can easily be adjusted by most manufacturers of bathroom tissue, facial tissue, napkins or paper towels, respectively, to commence or increase profitable production of any of these tissue products in the event of a slight price increase in any of these products. However, in view of evidence which suggested that the adaptation costs associated with switching from the manufacture of feminine hygiene products, disposable diapers and adult incontinence products to the manufacture of one or more of the tissue products listed above were such as to require a much more significant price increase in the latter to make it sufficiently attractive to make this production switch, capacity devoted to these products was excluded from the relevant market. On the demand side, the weak consumer loyalty and the high degree of price sensitivity with respect to the various grades of a particular tissue product were also significant considerations. This price sensitivity was attributable in part to ad campaigns of retail buying groups that frequently use tissue products as loss leaders.

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[65] Cf. Consumer and Corporate Affairs Canada, NR-10190, February 10, 1989.

With respect to the geographic extent of the market, notwithstanding the fact that certain competitors restricted their areas of operations to particular regions of Canada, (e.g., Eddy confined its tissue operations to Eastern Canada), the ease with which some competitors were able to ship products across the country was considered to be such as to warrant treating all of Canada as within the same relevant market. This conclusion was further supported by the fact that sales throughout the country were made on a freight equalized basis. By contrast, given various uncertainties relating to whether, when and the extent to which U.S. tissue producers would be likely to enter or expand their presence in Canada in response to a significant price increase, only actual imports, which accounted for less than 3% of domestic sales, (as opposed to plant locations and likely capacity to be allocated to the Canadian market), were included within the relevant market. The fact that the 10.2% tariff on converted products, and the 6.5% tariff on parent rolls, would be eliminated by the end of 1992, together with the fact that various U.S. producers located close to the Canadian border indicated that they would more seriously consider entering the Canadian market as these tariffs were lowered, were then considered in connection with the foreign competition and barriers to entry factors under section 93.

4.3 Algoma/Dofasco

This transaction concerned an acquisition by Dofasco Inc. of virtually all of the common shares of The Algoma Steel Corporation.[66] At the time of the merger, both companies were large vertically integrated steel makers that manufactured a broad range of intermediate and final steel products. However, each company produced a variety of specific product lines that the other did not manufacture. In this category were included tin mill products, pre-painted sheet, galvanized and galvalume sheet and strip, and electrical sheet and strip, produced by Dofasco, and heavy structurals, seamless tubing, rails, rail accessories, and wide rolled sheet and strip, produced by Algoma.

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[66] Cf. Consumer and Corporate Affairs Canada, NR-10138, September 30, 1988.

The principal issue that arose in the assessment of the product dimension of the relevant market in this case was whether these products competed in distinct markets or whether their supply cross-elasticities, and indeed the supply cross-elasticities between all steel products, was such as to warrant adopting a broader "raw steel" market definition. In the end, this latter approach was rejected for a variety of reasons, including: the facilities required to transform raw steel into various other products vary considerably depending upon the product sought, and are not capable of producing, or would not likely be adapted to produce, other downstream products in the event of a 5% or even 10% price increase;[67] companies such as mini-mills make raw steel but do not generally have the specialized apparatus to make hot and cold rolled sheet in significant quantities and would not acquire such equipment in the event of the threshold price increase; and, raw steel does not have an independent end use apart from its role as an input into products that require specialized and unique production facilities.

In the Bureau's view, this suggested that, absent demand side considerations, the product dimension of the market should be confined to those specific rolling mill and final products with respect to which Algoma and Dofasco actually competed. These were primarily hot rolled sheet and strip (HRSS), cold rolled sheet and strip and plate (CRSP), and finished tube and pipe (FTP). In view of the fact that the plants of the four vertically integrated Canadian steelmakers were sufficiently flexible to be capable of making most, if not all, of the variations of these products with minor or no additional investment, it was not considered appropriate to further narrow the analysis beyond these three product groups, respectively.[68] This fact was also considered to be a good reason for measuring market shares in terms of capacity, rather than actual output, in terms of sales or units. However, the capacity of aluminum companies with rolling mills was excluded after it was determined that they would not likely switch to the production of the products in question in the event of a significant price increase in the latter. Finally, captive sales within the integrated firms were excluded, given the fact that this production was not likely to be diverted away from the in-house manufacture of profitable downstream products in the event of the threshold price increase.

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[67] For example, rods, bars and structural shapes are produced from billets and blooms on equipment which cannot easily be converted to produce slabs and are rolled in mills which cannot produce sheets.

[68] CRSP cannot be produced on HRSS machinery, or vice versa, and FTP is a finished product that requires particular facilities.

From the demand side, it was determined that while there would likely be some switching to plastic and aluminum products in the event of a significant price increase with respect to HRSS, CRSP or FTP, the output lost in this regard would be trivial (due to the unique strength to weight ratio of steel), and not such as to warrant expanding the product dimensions of the three markets.

With respect to the geographic dimension, the market was confined to Canada for several reasons, including: Canadian prices for the products in question were, and had historically been, significantly below (20% in the case of HRSS) the landed cost[69] of U.S. and offshore steel; foreign sources of steel were not significant in terms of actual volumes brought into Canada; customers considered imports to be poor substitutes for domestic steel, not only in terms of quality, but also because of uncertain delivery times, servicing and technical problems; the need on the part of customers to retain a position on domestic allocation lists for periods of shortage; transportation costs and logistical problems (e.g., inability of foreign firms to regularly deliver on a "just in time" basis, and closure of the St. Lawrence Seaway for several months per year); and the restraining effect of antidumping legislation.[70] Given the fact that both of the other Canadian integrated steel makers would likely significantly increase their output in times of excess capacity in response to a price increase by the merging parties, and given that this threat, together with a similar albeit reduced ability of certain mini mills located in different regions of Canada to increase their output, appeared to contribute toward keeping prices significantly below U.S. prices, the market was considered to include all of Canada.

4.4 Westinghouse/ABB

This transaction involved the acquisition of the electrical power transmission and distribution business of Westinghouse Canada Inc. (WECAN) by Asea Brown Boveri Inc. (ABB), and raised concerns in relation to the manufacture and sale of large voltage power transformers.[71] The principal purchasers of large power transformers are provincial utility companies. The central issue that arose in the assessment of the product dimension of the relevant market in this case was whether the market should be expanded to include all power transformers. In view of evidence which strongly suggested that the linking of smaller transformers is more costly than purchasing one large unit, is technically inefficient and is only done for specific reasons such as to overcome logistical problems associated with placing a large transformer on a particular site; and in light of the fact that the substantial sunk-cost investments that would have to be made by manufacturers of smaller transformers in order to commence production of larger units would not likely be made in the event of the threshold price increase, the product dimension of the market was restricted to the following:

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[69] This includes a tariff.

[70] In the ten year period ranging from 1978-1988, approximately 90 anti-dumping complaints had been lodged in relation to imports of foreign steel products.

[71] Cf. Consumer and Corporate Affairs Canada, NR-10186, February 13, 1989; Consumer and Corporate Affairs Canada, NR-1-232, April 26, 1989; and Reasons for Consent Order, CT-89/1 Doc.101(a) (Competition Tribunal, June 15, 1989); *Canadian Competition Policy Record*, Vol. 10(3), 1989, p. 9.

(i) auto-transformers with a rating greater than 100 base Megavolt Ampers (MVA);
(ii) other transformers with a rating greater than 50 MVA; and/or a voltage classification of the 765 kilovolt class.

On the geographic side, the principal issues related to whether the procurement policies of provincial utilities warranted treating Ontario, Quebec and Manitoba, (where WECAN, ABB and the only other Canadian competitor were located, respectively), as distinct markets; and if not, whether the potential for foreign competition was such as to require the market to be expanded beyond Canada's national borders. The view that Ontario, Quebec and Manitoba constituted separate markets was rejected on the basis of the fact that the stated preference policies of provincial utilities was with respect to Canadian companies, rather than with respect to companies located in the same province as the utilities. In addition, there was little evidence to suggest that any advantage that may have been enjoyed by ABB, WECAN or Federal Pioneer in Quebec, Ontario or Manitoba, respectively, could be further extended. That is to say, it could not be established that any of these firms would likely be able to profitably impose a further significant price increase to the utility in their local market without facing a likelihood that business would be lost to one of the other two firms. In the other seven provinces, none of these three domestic firms appeared to enjoy a significant advantage over the others, except that Federal Pioneer did not make the largest categories of transformers.

On the basis of these and the following considerations, the Bureau's examination led it to the conclusion that the relevant market was national in scope: the existence of a tariff of 15% on power transformers imported from developed countries and 10% on such products imported from developing countries; the chilling effect that a high number of past antidumping proceedings had on the willingness of foreign competitors to bid in response to tender calls in Canada; the fact that many provincial utilities had never purchased a large power transformer from a foreign source; a lack of benchmark sales and demonstrated service and quality history, (which were particularly important factors to buyers in this industry), on the part of most potential offshore suppliers; and, to a lesser extent, the "buy Canadian" preferential purchasing policies of virtually every provincial utility; transportation costs; the low value of the Canadian dollar relative to the currencies of the countries in which the most likely foreign competitors were located; exchange rate risk; and the fact that imports accounted for significantly less than 10% of large power transformer sales in most years.

4.5 Hostess/Frito Lay

This transaction concerned the partnership between Hostess Food Products Limited and the Frito-Lay Division of Pepsi-Cola Canada Ltd..[72] At the time of the Bureau's review, both parties were primarily engaged in the manufacture and sale of a particular variety of salted snack foods that included potato chips, tortilla chips, cheese puffs and corn chips. Initially, there was an issue as to whether the market comprised all "snack foods", i.e., sweet snack foods, salted snacks, toasted pastries, frozen pies and dairy snacks such as yogurt and ice cream products. Sweet snack foods include chocolate confectionery, sugar confectionery, granola bars, cookies, dried food snacks and snack cakes and pies. Salted snacks include potato chips, corn chips, tortilla chips, cheese puffs, salted crackers, salted nuts, popcorn, pretzels and certain meat snacks. However, after preliminary examination, "snack foods" was rejected as too broad, and the analysis focussed upon whether the market should be considered to include all salted snacks or only certain salted snacks.

The Bureau ultimately concluded that the relevant market included potato chips, tortilla chips, corn chips, cheese puffs, pretzels, and popcorn; but not salted crackers, nuts or meat snacks. The reasons for taking this position included evidence which suggested that: the parties to the merger and the other principal sellers of the relevant market products did not price or otherwise market their goods in relation to crackers, nuts or meat snacks, but rather in relation to the potato chip products of their competitors (potato chips represented approximately 75% of total sales in the relevant market); sellers of the excluded products did not consider themselves to be in competition with the merging parties or other salted chip sellers; trade and consumer sources maintained that there was a much lower degree of substitution between the products included within the relevant market and those excluded than between the former; the fragile and comparatively perishable nature of the products included within the relevant market was such that these products required a different method of distribution and merchandising than the products excluded; retailers allocate distinct and well defined areas of shelf space to the relevant market products, and these areas are generally located a significant distance away from those sections in which the excluded products are sold; the included products are produced in very different facilities from the excluded products; and, to a lesser extent, empirical studies that had been undertaken heavily favored the "planned purchase" rather than the "impulse purchase" explanation of consumer habits in relation to the products in question. (The "impulse" theory suggests that a consumer wanting a snack makes an instantaneous decision as to whether the taste should be sweet or salty, and once this decision is made his impulse will be as likely to reach for one salted snack as another.)

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[72] Cf. Consumer and Corporate Affairs Canada, NR-1-146, November 16, 1988.

With respect to the geographic dimension of the market, the Bureau took the position that the four western provinces, where Frito did not compete, constituted a distinct relevant market, as did Ontario, Quebec, the Maritimes and Newfoundland, respectively. Its reasons in this regard included evidence which suggested that: the relatively insignificant levels of shipments from manufacturing facilities in southern Ontario to the western provinces would not likely appreciably increase in response to a 5% or even a 10% price increase in the west, and vice versa; the fragile and perishable nature of the products included in the relevant market is such that they are not generally shipped distances greater than 500 miles; transportation costs are such that product could not profitably be trucked in significant quantities from manufacturing facilities in Ontario to distribution points in Quebec, or vice versa, in response to a 5% price increase; the major client bases for these regions (i.e., wholesale groups and retail chains) are very different, or, if related, are negotiated with separately; regional tastes and/or purchase patterns are significantly different (i.e., certain flavors are preferred in particular regions, and family/single size portions are purchased in different ratios in these regions); the industry treats these regions as distinct markets; it is impractical (as evidenced by several cases of failure or poor performance) and highly unusual to have a direct store delivery (DSD) system in a region where one does not have a plant, unless no one else has a plant in that region (e.g. Newfoundland); if Ontario and Quebec were in the same market it would have made sense for each of the merging parties to close one plant pre-merger and supply both provinces from a single plant; northern U.S. manufacturers would not be in a position to increase their insignificant or non-existent share of Canadian sales in response to a 5% or even a 10% price increase, because the majority of accounts require a DSD system that would impose inordinate unit sales costs until such time as sufficient consumer acceptance was gained to achieve listings in major chain outlets; the point of sale disadvantages associated with not having a DSD system are substantial; it would take a substantial amount of advertising and time for U.S. entrants to overcome strong brand loyalty and longstanding relationships between incumbents and retailers; the tariff will only be reduced by 1% per year under the FTA; domestic labelling requirements and French language requirements would impose additional distribution and production costs on foreign producers.

4.6 Woodward's/Safeway

This transaction concerned Canada Safeway Ltd.'s acquisition of 23 Food Floors of Woodwards Stores Limited in 17 urban regions in Alberta and British Columbia, together with inventory.[73] On the product side, the Bureau's assessment focussed upon determining whether all retailers of products sold in supermarkets, i.e., convenience stores, superstores, specialty stores, farmers' markets, delicatessens, pharmacies and hardware stores, competed with Safeway and Woodward's to a degree that warranted their inclusion in the relevant market. With respect to the geographic dimension of competition, the principal issue was whether the relevant markets in question should include entire metropolitan areas, on the basis of supply side considerations such as city-wide advertising and central warehousing, or should be narrowed to reflect other considerations which suggested that price increases could be sustained in smaller areas.

The Bureau's assessment of the merger led it to the position that the relevant market should be confined to supermarkets and superstores. The reasons for this view included evidence which indicated that: supermarket operators monitored only the prices, advertising, product offerings, merchandising techniques and store hours of other supermarkets and of superstores, and largely ignored what took place in this regard at the other types of sales outlets listed above; the prices at these other sales outlets were significantly different than the prices at supermarkets (i.e., prices at specialty stores, convenience stores, pharmacies and hardware stores were typically much higher, whereas prices at farmers' markets were significantly lower); the correlation between the prices charged at supermarkets and superstores, on one hand, and the other sales outlets referred to above, on the other hand, was much weaker than between any two supermarkets or between supermarkets and superstores; the "cluster" of goods available at supermarkets and superstores was much different than what was available at the excluded sales outlets; pricing at the latter appeared to have very little impact on sales volumes at the former, and vice versa; consumers did not consider that the excluded sales outlets offered a competitive alternative to supermarkets, and indicated that they would not shift their purchases to these outlets unless supermarkets raised prices very substantially across the "cluster" of goods offered; consumers had a strong preference for the convenience associated with being able to purchase a wide variety of goods at a supermarket on a "one stop shopping" basis, rather than having to purchase their fresh produce at a farmers' market, their meat and cold cuts at a butcher shop, their non-prescription drugs and bathroom sundries at a pharmacy, their boxed food, canned food, and dairy products at a convenience store, and various other household products at a hardware store or other specialty store; and supermarkets offered, as part of their unique product mix, home delivery and credit card shopping that was typically not available at the excluded outlets.

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[73] Cf. Consumer and Corporate Affairs Canada, NR-87-7, May 20, 1987. See also NR-1-154, December 2, 1988. See *Canadian Competition Policy Record*, Vol. 8(2), 1987, pp. 7-8.

With respect to the geographic dimension of the market, the Bureau determined that in several instances it was appropriate to further narrow the relevant market to particular sections of urban areas, for reasons which included: a price increase in one section of a city or town often did not translate into a similar price increase in a neighbouring area; consumers typically did not find it convenient to travel more than two to three miles (slightly more in the case of superstores where significant discounts are available) for their grocery shopping; the costs associated with traveling to another section of a city or town in the event of a significant price increase would have been greater than the savings hoped to be achieved; purchase patterns were significantly affected by the presence of highways, rivers, railway lines, ravines, etc.; and retailers in neighboring urban areas could not divert supply to the area in question without encountering substantial entry costs.

4.7 Polysar/Nova

This transaction involved the acquisition by Nova Corporation of Alberta of 25 percent of the voting securities of Polysar Energy & Chemical Corporation.[74] At the time of the Bureau's review, Nova and Polysar were both major participants in the Canadian petrochemical industry. However, their only common activity related to the production of ethylene, which was generally accepted to be the appropriate "product market" for the purpose of the competition assessment. The major relevant market issue in this matter therefore concerned the geographic dimensions of the relevant market. In this regard, the question was whether Nova, which sold ethylene in Alberta, and Polysar, which sold ethylene in Sarnia, Ont., competed in the same market. The case in favor of a single relevant market was based primarily on suggestions and considerations that included: the flow of ethylene to Sarnia is limited not by economic, technical or natural barriers but by political barriers which may change; there would be potential for more ethylene to flow down the Cochin Pipeline, which was then operating at 50% capacity, when AGE III[75] comes on stream in the mid-1990s; Dow Chemical Canada Inc. had on several occasions in the past sold to third parties in Sarnia some of the ethylene it purchased in Alberta and shipped to Ontario via the Cochin Pipeline; at least one of Polysar's ethylene customers had engaged in swap arrangements with Dow to back ethylene out of the Cochin Pipeline for its own operations in Alberta; and Nova and Polysar competed for expansion opportunities, basing their investment decisions on the availability and cost of ethylene in both Sarnia and Alberta.

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[74] Cf. Consumer and Corporate Affairs Canada, NR-10082, May 5, 1988; *Canadian Competition Policy Record*, Vol. 9(2), 1988, pp. 9-10.

[75] There are currently two ethylene production plants in Alberta: AGE I and AGE II, both of which are operated by a Nova subsidiary, Alberta Gas Ethylene Co. Ltd.. Nova is also known to be contemplating construction of a third facility, to be known as AGE III, which would come on stream at the earliest in 1993. The output of AGE I is committed to the year 1998 and the output of AGE II is committed to the year 2004, through long term contracts.

However, Bureau staff recommended to the Director that he conclude that the merging parties operated in separate relevant markets, for reasons which included: ethylene is a volatile substance that can only be transported safely over any significant distance by pipeline at extremely low temperatures; the policy of the Alberta Government is to require ethylene produced in Alberta to be upgraded within the province, and there was nothing to suggest that this policy would *likely* change in the foreseeable future; the only ethylene that the Alberta Government permits to leave Alberta is the ethylene that is shipped via the Cochin Pipeline to Dow in Sarnia; the Dow volumes were explained by special circumstances connected with the origins of AGE I; Dow had retained most of this ethylene for its own downstream operations, and resold only marginal amounts on a sporadic basis; the swap arrangements referred to above were very infrequent and had involved less than 1% of Canadian ethylene production; Alberta ethylene production is committed pursuant to long term contracts to 1998 and beyond; no company in eastern Canada had proposed to build a derivative plant based on an Alberta sourced supply of ethylene for over 15 years; no ethylene flows from Sarnia to Alberta, because the Cochin Pipeline flows only in one direction; no ethylene flows into either of these two areas from the Montreal, Quebec or the U.S. Gulf Coast area, the only other significant ethylene production centres located in North America; the Alberta "cost of service" price had only minimal impact upon the Sarnia price, which at the time was tied to the U.S. Gulf Coast price; it is only in very special circumstances when the price of ethylene in Sarnia is significantly higher than in Alberta that it makes greater economic sense to ship ethylene from Alberta for upgrading in Sarnia, than to make derivative products in Alberta and transport them to Ontario; Polysar and Nova rarely competed with respect to ethylene because they seldom had ethylene available at the same time; long term "take or pay" contracts were an important institutional feature of the industry; and, all of the customers that Nova had lined up for supply from AGE III were committed to upgrading ethylene within Alberta.

Given the fact that virtually all ethylene production of the merging parties was committed under long term contracts lasting into the mid-1990s and beyond, the Director ultimately decided to defer for the three year period permitted by the Act his decisions relating to the geographic scope of the market and whether to seek an order from the Tribunal with respect to the merger. He indicated that during this period he would closely monitor, *inter alia*, Alberta Government policy regarding the export of ethylene from that province; changes in the economics of transporting ethylene on the Cochin Pipeline; the status of long term contracts and any early renegotiation of these contracts; and changes with respect to new entry or the expansion of existing ethylene production facilities in Ontario and Alberta.

4.8 Fruehauf/Trailmobile

This acquisition involved the acquisition of the voting shares of Fruehauf Canada Inc., by the Trailmobile Group of Companies.[76] At the time of the Bureau's review, Fruehauf and Trailmobile were the largest and second-largest manufacturers of highway trailers in Canada. Fruehauf made aluminum vans, fibreglass reinforced plywood (FRP) vans, platform trailers, semi-dumps and tanks for hauling bulk product (e.g., cement & sugar). Trailmobile made aluminum, steel and FRP vans and platform trailers. Given the lack of product overlap with respect to the dumps and tanks, which were products purchased for very different end uses than other trucks, and which were made from significantly different production facilities, these were not included within the relevant market for the purpose of the Bureau's analysis. Similarly, platform trailers, which are also made from significantly different production facilities than vans and have unique end uses, were excluded from further consideration after the Bureau confirmed that they are sold in a very different and very competitive market. The principal issue on the product side therefore concerned whether steel, aluminum, FRP and refrigerator (reefers) vans belonged in the same relevant market. With respect to the geographic dimension, the analysis focussed on whether the relevant market was rapidly becoming North American in scope, and on the extent to which this process would be accelerated by the then unsigned Free Trade Agreement (FTA), pursuant to which the current 15% tariff will be eliminated in equal (1.5%) stages over ten years.

The Bureau's assessment of the truck industry led it to conclude that reefers, which are primarily imported from the U.S., constituted a distinct relevant market, primarily due to the fact that they were priced substantially higher than standard vans and have a specific end use and differentiated value that justified their import. In addition, FRP vans were found to fall in a "grey area" at the fringe of the product market frontier because their usage was largely confined to less weight conscious buyers (e.g., the brewing and dairy industries) who placed a particular premium on the carrying capacity of FRP's and on their ability to withstand abuse; and because it was difficult to establish whether the facilities dedicated to the manufacture of FRP vans would likely be adapted to manufacture aluminum or steel vans in the event of a 5% price increase with respect to the latter. Given the relatively small share of Canadian van sales accounted for by FRP vans, the Bureau ultimately included them within the relevant market in order to focus the analysis on more fundamental issues.

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[76] Cf. Consumer and Corporate Affairs Canada, NR-88-4, January 18, 1988; and Consumer and Corporate Affairs Canada, NR-10124, July 11, 1988; *Canadian Competition Policy Record*, Vol. 9(1), 1988, pp. 5-6; Vol. 9(3), 1988, pp. 7-8; Vol. 10(1), 1989, p. 4.

On the geographic side, the Bureau concluded that it would be inappropriate to expand the relevant market beyond Canada, because: U.S. companies were found to have had very limited penetration into Canada; there was unanimous consent from American manufacturers and Canadian customers and competitors that the 15% duty on vans was effective in blocking sales by U.S. firms into Canada, despite a severe excess capacity situation in the American market; the weight of evidence suggested that U.S. van manufacturers would not likely commence to make significant inroads into the Canadian market until the tariff was well below 10%, (i.e., after 1992); U.S. vans sold for approximately 5.2% more than Canadian vans; the tax advantage associated with leasing a U.S. van was only available in relation to equipment employed in international trade; and most of the U.S. vans that had entered the Canadian market were ultra-lightweight vans that were neither available in Canada nor demanded by the majority of purchasers, who took full advantage of more liberal Canadian load carrying laws.

The Bureau's assessment suggested that a further narrowing of the relevant market to a specific part or parts of Canada was not warranted, because it would not likely have been possible for a significant price increase to be profitably imposed anywhere in the country. This was largely due to the fact that it was industry practice to have a truck delivered for no charge to the location of the purchaser's choice, by linking up with a third party that wanted a load transported to that location. Approximately six months after the Director permitted Trailmobile to proceed with its acquisition pursuant to Trailmobile's undertaking to divest its van business (including the Trailmobile name, equipment, tooling, designs and a national distribution network), and to operate the van businesses of Trailmobile and Fruehauf separately until completion of the divestiture, he was requested to reassess the situation in light of changing market conditions. These conditions included: a general North American industry downturn, brought on in part by widespread forecasts of a pending recession; an increased presence in Canada by U.S. suppliers, explainable in part by the appreciation of the Canadian dollar, and in part by the increased likelihood of the FTA being signed and an attempt to better position themselves for the post FTA environment; and a greater willingness on the part of Canadian buyers to lease American vans until the implications of changes within the industry could be ascertained.

In short, the Director found these developments, together with the fact that no serious expressions of interest had been made for the assets described in the Offering Memorandum circulated by an independent broker, and together with Trailmobile's revised proposal to combine[77] the production operations of itself and Fruehauf in order to gain significant efficiencies and better prepare for both the industry downturn and a post-FTA environment, to be a sufficient basis to accept revised undertakings. Accordingly, he released Trailmobile from its initial undertakings and agreed instead to the sale of the Trailmobile name and associated intellectual property (including drawings and designs), in order to facilitate future entry or expansion in the market.[78]

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[77] Trailmobile's initial proposal was to operate Fruehauf as a separately managed operation and distinct profit centre, complete with its own sales force.

4.9 Carling O'Keefe/Molson

This transaction concerned the merger of the Canadian based brewing operations of The Molson Companies Limited and Elders IXL Limited, the parent company of Carling O'Keefe Breweries of Canada Limited.[79] At the time of the Bureau's review, Molson and Carling were the second and third largest brewers in Canada, with plants in most provinces and sales in all provinces plus the two territories. The principal relevant market issue in the Bureau's review of this matter related to the scope of the product market. In this regard, the question was whether beer should be viewed as a distinct market or as competing in a dynamic "beverage market" against a broad spectrum of drinks, including soft drinks, coffee, tea, milk, juices, powdered drinks, bottled water, coolers, wine, beer and distilled spirits. In support of this latter view were, *inter alia*, various statistics that appeared to indicate a shift in per capita consumer demand away from alcoholic beverages generally, and away from beer and spirits in particular, toward other beverages, as a result of increased health and safety consciousness, higher increases in taxes relative to other beverages, and changing age demographics. It was suggested that these statistics further indicated that the aggregate demand for beer was somewhat price sensitive.

The Bureau's analysis led to the conclusion that beer constituted a distinct relevant market, for reasons which included: statements by consumers, union groups and others in the beer industry that other beverages are neither substitutable nor considered by many people to be substitutable for beer; evidence which suggested that demand would not shift significantly to other beverages in the event of a 5% or even a 10% price increase; evidence which suggested that consumers view beer not only as a beverage but also as a product which contributes to a particular lifestyle and self-image; the fact that manufacturers of other beverages would face very substantial switching costs and other barriers which would prevent them from being able to commence the profitable production of beer in response to a 5% or even a 10% price increase in beer; other beverages do not have a similar taste, colour or texture as beer; other beverages have significantly different prices than beer; and the prices of other beverages are not closely correlated with the price of beer.

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[78] Trailmobile fulfilled its revised undertakings in early 1989. See Consumer and Corporate Affairs Canada, NR-10162, January 9, 1989.

[79] Cf. Consumer and Corporate Affairs Canada, NR-10256, July 6, 1989; *Canadian Competition Policy Record*, Vol. 10(3), 1989, pp. 2-4.

It was not considered to be appropriate to further narrow the product dimensions of the market, for reasons which included: the high correlation between the prices of premium beers and the prices of discount and regular beers; evidence which clearly suggested that regular and premium beer prices were constrained by discount beer prices, (and vice versa), and could not be significantly raised without a net loss of profits; and evidence of weak brand loyalty.

On the geographic side, the Bureau's analysis confirmed that each of the ten provinces and two territories constituted distinct relevant markets. This conclusion was based on the fact that, with few exceptions, provinces encourage the production of beer within the province through elaborate regulatory regimes which effectively discriminate against out-of-province and foreign beer with respect to listings, mark-ups and, in some cases, distribution channels. In addition, in many provinces, regulation effectively constrains important dimensions such as price, advertising, promotion, distribution and/or packaging. It was not considered to be appropriate to further narrow the geographic dimensions of any of the twelve markets because it was determined that it would not be possible for a significant price increase to be sustained only in a particular region of a province (in jurisdictions where price is not regulated).

Chapter 12

FIRM TURNOVER AND MARKET STRUCTURE: CONCENTRATION STATISTICS AS A MISLEADING PRACTICE

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1.0 INTRODUCTION

On the hundredth anniversary of Canada's competition legislation, it is useful to ask whether both the policy and the practice thereof are headed in the appropriate direction. Other papers in these volumes have addressed the broad issues of policy and administrative practice. In this paper, we address a much narrower but nevertheless important question. We investigate the appropriateness of the economic data that is so often used by professional economic staff during the formulation of policy and its administration. In particular, we focus on the most widely used proxy of competitive conditions in an industry -- the concentration ratio -- and suggest it is time to begin using more direct measures of the intensity of competition, measures that modern computer technology have recently made available.

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The concentration ratio is frequently used to provide a descriptive statistic of the state of competition. In cross-sectional studies of industries, the level of concentration is used to rank industries by the intensity of competition therein. In addition, trends in the level of concentration are used to infer whether these conditions persist. In other work (Baldwin et al., 1986), we have shown that the level of concentration, as normally measured, is biased upward by its failure to consider imports. In this paper, we outline how misleading both the concentration ratio and trends therein can be when used to infer stability in the underlying firm population.

It has long been recognized that concentration measures provide only a proxy for competitive conditions and cannot capture the variety of competitive circumstances that exist. But few attempts have been made to measure the intensity of competitive conditions by a more direct measure -- the extent to which some firms replace others during the competitive struggle for dominance.

This reflects in part the assumption that high concentration industries have high barriers both to entry and to internal mobility, and that in low concentration industries the converse is true. For then the concentration ratio is an adequate proxy for the amount of turnover by industry -- adequate for the purposes of ranking industries on a relative scale but inadequate for reporting the true picture of the amount of turnover that continuously takes place. The lack of attention paid to mobility statistics also partially reflects the assumption that the factors that are likely to change the level of concentration -- shifts in demand, variability in demand, technical change -- also determine mobility. For then changes in concentration will be related in mobility.

This paper reports on the results of a research project carried out at Statistics Canada to provide measures of the degree of turnover taking place within industries. It is this turnover that directly measures the effects of competition and, therefore, provides a more thorough understanding of its intensity.[1] The resulting mobility measures, which are only summarily reported herein, give a different view of the market structure than the conventional concentration statistics. The mobility measures show considerable movement of firms within industries.

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[1] The empirical results reported herein summarize an extensive research programme. Much more detail may be found in Baldwin and Gorecki (1989a to 1989g).

2.0 CONCENTRATION STATISTICS AS THE CONVENTIONAL WISDOM

The field of industrial organization, and to a lesser extent, the practice of competition policy, has been dominated by U.S. textbooks, theory and debates. The work of Mason, Bain, Caves, Baumol, Scherer, Stigler, Weiss, Shepherd, and Demsetz provide a testament to that influence. U.S. thought and research has had a particularly strong influence in determining the economic and legal professions' view of market structure and the appropriate policy framework for many aspects of competition policy. Most commonly, market structure is characterized as having considerable inter-temporal stability. This is based upon two inter-related but mutually reinforcing factors, one empirical, the other theoretical.

The measure of market structure that is most widely used in the U.S. (and for that matter in other countries such as the U.K. and Canada) is a measure of concentration. The most commonly used concentration measure is the percentage of output (or any other indicator of industry size, such as employment or assets) accounted for by a small number of the largest firms -- typically four in North America. Measures of concentration capture characteristics of the firm size distribution at a point in time. The size distribution changes slowly over time and so do the associated measures of concentration. These results have been found in a series of U.S. studies, such as those by Adelman (1951) and Mueller and Hamm (1974), which have been summarized as follows by Scherer, in his widely used textbook:

> to sum up, average industry concentration levels in U.S. manufacturing apparently increased quite modestly during the quarter century following World War II. Less solid evidence suggests that the increase was slight even when compared to the levels prevailing at the turn of the century. As Professor Adelman concluded in an earlier study of concentration trends, "Any tendency either way, if it does exist, must be at the pace of a glacial drift" (Scherer, 1980, p. 70).

Schmalensee (1988, p.644), in his recent survey of industrial organization, reiterates this position when he refers to market structure as "relatively stable."

Canadian work falls squarely in the mainstream of the profession with its exclusive emphasis on concentration to measure market structure. Rosenbluth's classic studies (1955, 1957) for the NBER provided the foundation for a generation of research. Subsequent work, originating in the research group of the Bureau of Competition Policy (Khemani, 1980), updated the work and continued to place its main emphasis on concentration. The Royal Commission on Corporate Concentration (1978), by its very title, shows the preoccupation of policy-makers with the size distribution of firms rather than with internal aspects of the competitive process.[2] More recently, research for the Royal Commission on the State of the Economic Union (1985) continued to place the same emphasis on static market structure concepts (see Khemani, 1986) and not on dynamic market turnover characteristics that better demonstrate the strength of the competitive process. While the latter do not go completely unnoticed, the continued reliance of tables of concentration statistics in these studies is indicative of their primary focus.

Canadian studies, like those done for the United States, give the impression that market structure changes are relatively unimportant since they show relatively slow changes in concentration in the manufacturing sector. In a study that examines the period from 1948 to 1972, Khemani (1980, Chart 4-2, Panel 1, p. 54) finds, for a sample of 57 comparably-defined industries, that the mean level of the four firm concentration ratio only increased from 44.4 per cent to 48.3 per cent. Marfels (1977), for a larger sample of 103 manufacturing industries taken from 1965 to 1972, reports little change in mean concentration. Krauss and Lothian (1988, p.1), in reviewing these and other studies for Canada, concluded "over time this analysis produced a body of statistics which concluded that up to the mid-1970s concentration though fairly high had remained constant".[3]

The empirical generality that emerged from these concentration studies, both here and abroad, was consistent with the "most influential" (Reid, 1987, p.11) paradigm used in industrial organization studies over most of the post-war period. Developed in the 1930s at Harvard by Mason (1939, 1949), and subsequently extended by Bain (1956, 1959), the structure-conduct-performance (SCP) paradigm of industrial organization for a long time treated industry structure as being determined primarily by exogenous factors such as technology and public policies. Industry structure, in turn, influenced industry conduct and ultimately performance. This provided the framework that guided a number of case studies and, with the introduction of econometrics, many inter-industry cross-sectional empirical studies of the SCP relationship. Canadian work in this area has tended to be an extension of American both in spirit and methodology.

Implicit in much of the discussion of the SCP was the view that the basic technical conditions that determine market structure, and thus market structure itself, change only gradually over time. To some extent, this was the result of the uni-directional flow of causation from structure to performance that was used. But it was also affected by the measures of concentration that were employed. While those who utilized the SCP framework recognized that market structure possessed several important dimensions -- the number and size distribution of sellers and buyers, product differentiation, entry barriers and others -- "the concentration characteristic, particularly with respect to sellers rather than buyers, has received by far the greatest attention" (Reid, 1987, p.12). This measure has varied little over time and its use, therefore, has contributed to the view that market structure is stable. The assumptions underlying the SCP paradigm and the finding of slowly changing industry concentration were mutually reinforcing.

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[2] The Commission spent considerable resources trying to establish the direction of the trend in concentration. See Marfels (1977).

[3] See Statistics Canada (1983) for a summary of concentration trends from 1970 to 1980.

This belief in the stability of industry structure and its impact on performance led in the U.S. to the proposal in 1968 by the Neal Task Force that ".....any industry in which the four biggest firms persistently accounted for 70 per cent or more of its output would have its structure compulsorily altered by the state, to be achieved by reducing the size of firms with each more than 15 per cent of the industry's output" (Yamey, 1985, p. 119). This marked the zenith of the belief that the simple SCP model provided a guide for policy. In Canada, with a much less restrictive anti-trust policy that was based on concern over the trade-off between scale economies and concentration, such straightforward remedies were never deemed practical.

More recently, feedback relationships between performance and structure have been modelled; but these are still regarded as second order effects. Moreover, much of the emphasis in this literature is on stability, not change. Incumbents can adopt preemptive strategies which solidify their position and discourage or blockade entry.

Despite this preoccupation with stability rather than change, there are a number of recent developments that have placed much greater emphasis on market dynamics, on intra rather than interindustry and on firm rather than industry analysis. This has resulted from developments in contestability theory, the concept of strategic groups, and a desire to go beyond the static SCP model by considering and modelling such things as entry and exit. This renewed interest has led to much new empirical work as recent special issues of the *Journal of Industrial Economics*, (Vol 35,1987) and the *International Journal of Industrial Organization*, (Vol 5,1987) demonstrate.

It has long been recognized that market structure, as measured by concentration ratios, may be unchanging at the same time as there is considerable underlying change in the number and the size distribution of firms and the identity of the leading firms. While some have suggested, therefore, that measures should be utilized that consider the extent to which firms change position within an industry, their admonishments have had little practical effect. There have been few systematic attempts to investigate the characteristics of market dynamics across a wide range of industries. Early work by Gort (1963) on changes in market share stability showed that, between 1947 and 1954, very little mobility took place. Although this post-war period is somewhat unusual, Gort's results have been used by Scherer (1980, p.74) to argue that mobility measures offer little information in addition to that provided by concentration statistics. Most expositions of structure even today focus almost exclusively on concentration measures as opposed to the mobility measures that capture the extent of intra-industry movement.

This study is meant to fill the gap in our knowledge about the relationship between market dynamics and structure. It proceeds from the general to the specific. First, the impression of market dynamics as presented by traditional concentration measures is discussed. Then a broad overview is provided of the amount of change taking place. This is done by focusing on the amount of simultaneous growth and decline of firms, both in the short and long run. It examines two separate but related forces that determine the amount of turnover that is taking place. The first is the amount of entry and exit.[4] The second is the amount of expansion and contraction that simultaneously takes place in the continuing firm population.[5] This overview emphasizes the extent to which the rise and decline of producers is important.

Subsequently, several mobility statistics are presented that provide more detail on the extent to which market share is transferred from some firms to others within industries. The mobility statistics separately measure the market share change associated with entry and exit as opposed to the change caused by the growth and decline of firms. The relationship between turnover caused by entry and exit versus incumbent growth and decline is also investigated. These measures give a very different picture of market structure than is fostered by an examination of concentration statistics.[6] Moreover, as is shown later in this paper, the two sources of turnover are not related one to another in a broad cross-section of industries. Turnover is multi-faceted.

3.0 PATTERNS OF CONCENTRATION CHANGE

While measures of concentration were devised primarily to evaluate differences across industries in the competitive environment, changes over time have been used to analyze long term trends in the competitive environment. When this is done, very little change appears to be taking place.

An evaluation of trends in concentration can choose from a myriad of measures. These measures generally reflect at least two-dimensions of the size distribution. These are the number of firms and their size variance. Discrete measures such as the N-firm concentration ratios capture only part of the distribution -- the market share of the top N firms. Summary measures such as the Herfindahl, the Entropy, the Rosenbluth, and the Horvath use the data on all firms in the size distribution. Essentially they differ one from another in how the market shares of different firms are weighted.[7]

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[4] For more extensive discussion of entry and exit, see Baldwin and Gorecki (1989a).

[5] This topic is dealt with in Baldwin and Gorecki (1989c).

[6] For more detail on the relationship between concentration and mobility statistics, see Baldwin and Gorecki (1989c).

The literature has tried to distinguish between these measures on theoretical grounds -- asking which measure would be suggested by a particular oligopoly theory, or which satisfied a certain set of axiomatic conditions -- but it has failed to reach a consensus as to the superiority of any particular measure. Fortunately, as an empirical matter, these distinctions are not very important. As Van Lommel et al. (1977) and Baldwin and Gorecki (1988) have shown, there are really very few differences in the cross-sectional variability of the various concentration measures and for the purposes at hand, the various measures yield the same results. For illustrative purposes, the four firm concentration measure is used here to evaluate the trends in concentration in the 1970s.

An overall assessment of Canadian trends using data for the years 1970, 1975, and 1979 using four-firm concentration ratios at the 167 4-digit manufacturing industry level shows virtually no change in average concentration. The level of concentration, as measured by the unweighted mean, moved imperceptibly in the 1970s. For example, over the decade 1970 to 1979, the mean proportion of industry shipments accounted for by the leading four firms declined by one percentage point from 50.9 to 49.9 per cent. This slight decline can also be found if the share of the top eight firms or the Herfindahl are used.

Since it is somewhat arbitrary to use the top four or the top eight firms to calculate the market share dominated by a small subset of firms, the average share of each grouping from the top firm to the top ten firms was calculated and plotted for both 1970 and 1979 in Figure 1. The similarity in the two distributions confirms the earlier results. Very little change occurred in the overall firm size distribution.

It is, of course, possible that these manufacturing sector averages are concealing considerable changes at the industry level. This is not the case. When the ratio of the concentration in 1979 relative to the concentration in 1970 is calculated for each industry, this variable is found to centre on one. The unweighted mean of this ratio for the four-firm concentration measure was 1.0007.

This does not imply there are no changes in concentration in individual industries. Some industries experienced significant change. But there were few such industries. In order to show the degree to which the overall distribution changed, a widely-used classification system was employed to group all industries in a particular concentration category in 1970 and then the same system was used in 1979. A comparison of the results shows how many industries shifted categories.

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[7] See Curry and George (1983) or Hannah and Kay (1977) for a general discussion of concentration statistics.

The classification system used in the case of the four-firm concentration ratio was; highly concentrated oligopoly (1.00-0.75); moderately concentrated oligopoly (0.50-0.749); slightly concentrated oligopoly (0.25-0.499); and atomism (0-0.249).[8] Table 1 presents the cross-tabulations using the above classification. The tabulations confirm the earlier impression of stability. Of the 167 industries, 79 per cent or 132 remained in the same concentration class. Furthermore, of those industries that did change concentration classes, most movement was to an adjacent class.

The picture that is given by this type of exercise is one of insignificant change in market structure. Any trends that are discernible hardly suggest a vital and dynamic state of competition. In order to draw less pessimistic conclusions, reference has to be made to increasing import competition and the change in the competition offered by the offshore competitors.[9] It is true that offshore competition matters. When imports are considered, the number of industries that fall in the most concentrated category falls substantially (Baldwin et al, 1986, p.536). Nevertheless, while offshore competition is important, there is no reason to rely only on such secondary evidence. More direct evidence in the form of mobility statistics exists on the amount of change that is continuously taking place.

4.0 ISSUES IN THE MEASUREMENT OF MARKET DYNAMICS

The type of mobility statistics chosen to characterize the degree of intra-industry movement will depend on both the nature of the data available and the objectives of the analysis. Decisions have to be made regarding the industry level at which the statistics will be calculated, the time period to be chosen, and the degree of detail to be contained in the statistics. Mobility statistics can be calculated at the level of the manufacturing sector as a whole or at more disaggregated industry levels. They can cover the short or the long run. They can distinguish between separate components such as entrants and exits as opposed to continuing firms. In this section, each of these conceptual issues is briefly discussed and the data sources and definitions presented.[10]

4.1 Conceptual Issues

If interest in mobility statistics relates to their usefulness in providing information about market structure, then the statistics need to be defined at the level that are used for concentration statistics. This requires a level of disaggregation at the 3 or 4-digit level for a detailed analysis. However, a more aggregated level may be chosen to illustrate general tendencies, particularly when they can be interpreted as representative averages of the underlying industry data. In what follows, aggregate manufacturing industry level data are used to provide a broad overview, then disaggregated data are used to measure more detailed aspects of intra-industry movements in relative position.

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[8] See Green (1980, p.45) where this scheme has been previously used.

[9] For one such example, see Khemani (1986).

[10] More detail can be found in Baldwin and Gorecki (1989b).

The choice of the time period for study is important because the various components of change within industries may vary in importance in the short as opposed to the long run. This study focuses on both the short and the long run. The broad overview uses both to show how different the results are when different time periods are used. Short-run results show much more change in the continuing firm sector than for entrants and exits; but a large part of the former is transitory. More detailed industry level material is presented for the long run so as to capture the permanent component of change that is caused by the competitive process. For it is the latter which is of most interest to those assessing the impact of a particular competition policy.

4.2 Data Considerations

Decisions on the type of mobility measures to use cannot be taken in isolation of the data base available for the exercise. The construction and interpretation of mobility statistics must be cognizant of the strengths and weaknesses of the data base being used. This study makes use of data that come primarily from the Canadian Census of Manufactures.

Census data offer the advantage of comprehensiveness over those that have been constructed from the trade press. Their disadvantage for the calculation of mobility statistics is that they are often not collected for the purpose of calculating mobility statistics. To do so, the identifiers attached to plants and firms[11] have to be constructed properly to provide a longitudinal panel. Fortunately, Canadian firms and plants can be followed over time. Furthermore, firms and plants can be linked together.

In the Canadian case, there is a unique identifier associated with a plant. It disappears only if the plant ceases production in the manufacturing sector or the plant has changed its name, owner and location simultaneously. The disappearance of the plant identifier from the universe of all plant identifiers is used here to define a plant death. The converse event is used to define a plant birth. Because the situation in which a plant identifier disappears is narrowly defined, the meaning attached to a plant death is straightforward.[12]

In contrast, the disappearance of a firm level identifier in the Canadian data can result from a number of separate events. First, the firm identifier may cease to exist because all its plants are closed. Secondly, a firm's identifier may change even though the plant identifiers associated with the original firm continue as part of a new firm. In the latter case, the firm has exited as a result of a corporate reorganization -- a broad classification which includes divestiture as well as consolidations and other forms of corporate legal change. Therefore, firm entry and exit is divided into two categories to reflect the two forms in which it occurs.

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[11] Statistics Canada uses a number of different terms such as business unit, corporation, or consolidated enterprise to refer to a firm. For ease of reference, the term "firm" is used here as a generic term and, where necessary, the particular meaning used is defined for the reader.

[12] The validity of this rule is investigated at length in Baldwin and Gorecki (1989b).

4.3 Mobility Statistics

This section proceeds in two stages. First, a broad overview of the intra-industry dynamics is provided by focusing on firms defined at the level of the manufacturing sector as a whole. The dimensions of change are restricted to two -- that arising from entry and exit and that resulting from the growth and decline of continuing producers. Change is measured for both short- and longer-run periods. The first is accomplished by looking at annual changes; the second is derived by comparing endpoints six and eleven years apart. The short- and long-run results differ critically in that entry and exit in the long run is relatively more important than change in the continuous segment.

The second stage presents more detailed measures of the cumulative effects of entry and exit measured at the 4-digit industry level to confirm the results derived at the overall manufacturing level. The status of firms in 1970 and 1979 is compared so as to provide more detail on the importance of the various means of entry and exit. Both entry that is associated with new plant construction and with the acquisition of existing plant by outsiders are measured separately. The distribution of turnover activity by size class is also presented. Finally, mobility statistics are calculated for each 4-digit industry that capture the market share that is being shifted from firms that are declining to those that are growing in relative importance.

An Overview of Short- and Long-Run Change at the Manufacturing Level: Intra-industry dynamics are measured first by focusing on changes in employment associated with a turnover category. Employment changes are measured at the level of the consolidated firm.[13] Two components of change are captured -- entry and exit on the one hand, growth and decline in continuing firms on the other hand.

An entrant is defined as a firm that owned plant in the manufacturing sector in year t+1 but not t. An exit is defined in the opposite fashion. Each of the entry and exit categories is divided into two. Entry is divided into greenfield entrants (those entering via plant opening) and acquisition entry (those entering via acquisition of existing plant). Exits are divided into closedown exits (firms leaving by closing plant) and divestiture exits (those leaving by divesting themselves of plant).

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[13] The consolidated firm consists of all establishments within manufacturing under common control.

Growing firms are those that expanded employment over the period; contracting firms are those that decreased employment. Growth and decline within the continuing sector can arise from three separate sources. The first source is the expansion or contraction of existing establishments. The second is the opening and closing of plants. The third is due to acquisitions and divestitures of plants. The joint effect of all three is reported below.[14]

(i) Short-run change: In order to estimate the various components of turnover in the short run, the status of firms was compared in successive years from 1970 to 1982. Rates of employment change were calculated as the level of employment in the entering or exiting firm, or employment changes in continuing firms, as a percentage of employment in the previous year in the manufacturing sector as a whole.

The data in Table 2 show that, on average, during the 1970s all entrants accounted annually for 2.0 per cent of manufacturing employment; exits for 3.2 per cent. The two entry categories were about equally important. Greenfield entry accounted for an average of 0.9 per cent annually, acquisition entry for an annual average of 1.1 per cent. Greenfield entry and closedown exit were, on average, about the same.

Expansion and contraction rates in the continuing sector were considerably larger than the entry and exit rates. There was an average annual gain in employment in expanding firms of 7.8 per cent; and an average annual loss in contracting firms of 6.3 per cent annually. Together the two processes led to substantial churning in the short run, though entry and exit appear to be relatively unimportant.

(ii) Longer-run change: Expansion and contraction in continuing firms dominates the entry and exit process in the short run. Whether it does so in the long run depends upon whether the short-run rates for entrants and exits as well as for continuing firms are sustained over time.

For entrants, the relative importance of the two components in the longer run need not be the same as in the short run for several reasons. The relationship between the short- and long-run results will depend on the length of life of entrants and their growth rates subsequent to entry.[15] If all entrants experience a relatively short life and a slow growth rate, then the cumulative long-run results will differ little from the instantaneous or short-run results. On the other hand, if at least some entrants survive and grow and this outweighs the effects of exits from recent entrants, then the cumulative effect of entry will be greater in the long than the short run, when measured as a percentage of base year employment.

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[14] Instead of focusing on change at the firm level, establishments could have been used for the analysis. The latter are more appropriate for a study of the impact of change on job creation and destruction. See Baldwin and Gorecki (1990).

[15] This is discussed extensively in Baldwin and Gorecki (1989c).

The long-run rates for continuing firms are not likely to be the same as the short-run rates because these firms do not typically grow or decline continuously over long periods of time. Rather they tend to alternate between periods of growth and decline, due to economy-wide cyclical factors, industry-specific characteristics and managerial factors that limit growth. Short-run growth and decline rates contain a permanent and a transitory component. Other work (Hall [1987], Leonard [1987]) has shown that the transitory component is large. Hence the annualized long-run rate of change for expanding (or declining) firms will typically be less than the short-run rate.

In order to examine the importance of the sources of change when calculated over longer periods, the rates of employment change were calculated for entrants, exits and growing and declining incumbents. Once again, the firm is defined at the level of the manufacturing sector as a whole. The rates of change were estimated using two six year periods -- 1970 to 1976 and 1975 to 1981 -- and one eleven year period -- 1970-1981 -- and are presented in Table 3. Panel A contains the cumulative rate of change obtained from comparing the status of firms at the beginning and end of each period. Panel B contains the equivalent annual rate derived from these cumulative rates of change.[16] Panel C provides the average annual rate derived from the year-to-year changes calculated within each period.[17]

The year-to-year growth rates for continuing firms are considerably greater than the equivalent annual rates calculated for firms that grew or declined for longer periods as a comparison of Panels C and B indicate. For example, the average short-run or yearly decline rates were some 6 per cent in each of the two five year periods; the equivalent annual long-run decline rate over each of these two periods derived by comparing the status of firms in the opening and closing years was only about 2 per cent for each of these two periods. These differences indicate that substantial reversals in the short-run fortunes of continuing firms took place in the longer run.

By way of contrast, the equivalent annual long-run entry and exit rates are very similar to the short-run rates. For example, the average of the short-run greenfield entry rates from 1970 to 1981 was 0.9 per cent but the equivalent annual rate derived from comparing the 1981 size of all successful entrants between 1970 and 1981 to 1970 total employment was also 0.9 per cent. This implies that those entrants that survive and grow offset the impact of the high infant mortality rates of entrants.

While continuing firm expansion and contraction dominate the churning that takes place in the short run, this is no longer the case for the decadal comparison. The decline in the short-run expansion and contraction rates and the maintenance of the longer-run entry and exit rates at their short-run values leave the two processes about equally important. Over the period 1970-1981, the equivalent annual expansion rate for incumbents was 2.2 per cent; the equivalent annual entry rate from both acquisition and greenfield entry was 2.2 per cent. The equivalent annual contraction rate was 1.1 per cent; the equivalent annual closedown exit rate was 1.0 per cent.

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[16] The equivalent annual rates are those rates which when compounded annually over the period equal the cumulative rates.

[17] The rates in Panel C do not correspond exactly to those in Table 2 for reasons that are discussed in Baldwin and Gorecki (1990, Appendix B).

Just as important as the relative magnitude of the entry and exit as opposed to incumbent turnover is their cumulative effect. Figure 2 is a bar chart depicting the total cumulative contribution made to employment by firm expansion and the two forms of firm entry; contraction, and the two forms of firm exit between the years 1970 and 1981. Greenfield entry added 10.9 per cent, acquisition entry affected 14.6 per cent, and expansion in the continuing sector added 27.2 per cent to 1970 employment. Closedown exits led to a disappearance of 10.5 per cent of 1970 employment, divestitures affected 17.7 per cent of employment, and employment contracted in declining firms by an amount equal to 11.0 per cent of initial total employment in all firms. While it is true that short-run changes in firm size are mainly transitory, there is nevertheless a large subset of firms that contract over the long term and the cumulative change in these firms is substantial. Combined with the fact that some firms are also experiencing substantial growth, this implies that the relative size of firms must be experiencing substantial changes.

The nature of the change in relative position is particulary evident when, as in Figure 3, the average size of a declining firm is compared to the average size of an expanding firm in the initial and terminal years of the period. Between 1970 and 1981, over one-third of the firms lost employment. Contracting firms declined from an average of 161 to 109 employees; expanding firms grew from 105 employees to 183 employees. This is a dramatic change in the relative size of the two groups and one that indicates the magnitude of the long-run change in relative firm size that the growth and decline reported here is producing.

Two conclusions emerge. First, while continuing or surviving firm activity is of substantial importance, the longer the time period selected, the more important the entry/exit process becomes relative to that of continuing firms. Secondly, there is a general process of growth and decline, part of which is manifested by entry and exit, part of which causes producers who stay in the industry to move up and down in the size distribution. Together these processes lead to considerable change when cumulated over a decade.

Long-Run Change Due to Entry and Exit at the 4-digit Manufacturing Industry Level: While the data for entry to the manufacturing sector show that decadal turnover is not insignificant, they may understate the importance of entry because they focus only on entry by firms outside the manufacturing sector. In order to investigate more fully the extent of change at a finer level of industry aggregation, entry statistics are calculated at the 4-digit level by comparing the status of firms and establishments in 1970 to 1979. The longer period is chosen so as to minimize the amount of transitory change that the short-run estimates have been shown to contain. The data base allows the calculation of the importance of the different methods of firm entry and exit and permits a comparison of the importance of the entering and exiting segment to that of continuing firms. Entry and exit is first examined by itself and then considered in the context of selected measures of change within the continuing firm population.

The importance of entry and exit is derived from a data base that links the creation of new plants to firms. Establishments are classified as births (existing in 1979 but not 1970), exits (existing in 1970 but not 1979), or continuing (existing in both 1970 and 1979). Establishments are then aggregated into firms at the 4-digit industry level. A firm is defined to consist of all establishments at the 4-digit SIC level under common control. Enterprises are grouped into new firms, exiting firms, and continuing firms on the basis of the status of their plants.[18]

New firms are divided into three groups -- those that entered by building new plant, by acquiring existing plant, and by switching plant from another industry. Similarly, exiting firms are divided into those that did so by divesting themselves of plant, by closing plant, and by switching plant to another industry. Finally, the plants of continuing firms are divided into those that were newly built, those that were transferred into an industry, those that were closed, those that were transferred to another industry, those divested, those acquired, and those that survived without a change in ownership status. Because of the classification scheme used, the plant creation and destruction process for continuing firms can be compared to that for the entering and exiting segment. Similarly, the merger process for continuing firms (horizontal) can be compared to that which brings new firms into an industry via acquisition.

Table 4 details the importance of the various categories: first, in terms of the proportion of the number of establishments involved, and secondly by the relative proportion of the new, acquired, divested, and closed plants' shares of industry shipments. In each case, the proportion cited is the mean taken across all 167 4-digit industries.

The individual 4-digit industry level data confirm the importance of the entry and exit process in the long run that was found using turnover data for the manufacturing sector as a whole. The cumulative effect of entry and exit over the decade of the 1970s is large. As of 1979, firms that were new to the industry since 1970 accounted for, on average, 33 per cent of all establishments and 27 per cent of shipments. Firm exits over the decade accounted for, on average, 40 per cent of the number of establishments in 1970 and 31 per cent of shipments.

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[18] See Baldwin and Gorecki (1983, 1989b) for a discussion of the data base used for in this section.

A large portion of firm entry and exit involved plant births or deaths. If the number of establishments is used as a measure of importance, the entry process is dominated by plant creation. In 1979, 18.8 per cent of establishments had been created since 1970 by entrants. Only 8.7 per cent of establishments were owned by firms that were entrants via acquisition. In contrast, when shipments are used, entry by new plant creation and by diversified merger are more equally split -- accounting for 11.5 and 10.7 per cent of 1979 shipments, respectively.

As was the case with entry, the importance of the two exit processes (divestiture versus plant closure) differs, depending upon whether it is measured by the number of establishments affected or by their share of shipments. In terms of number of establishments, exit via plant closure was more important. In terms of percentage of shipments affected, exit via closure and via divestiture were about equally important.

Finally, it should be noted that transfers of plants from one industry to another contribute to the reallocation process. About 5 per cent of establishments were switched from one 4-digit manufacturing industry to another in a process that involved firm exit and entry. These plants contributed about 5 per cent to industry shipments in both 1970 and 1979.

Several comparisons can be made at this stage between the entry and exit process and the activity of continuing firms. The various entrant and exit categories outlined in Table 4 were more important than the same categories for continuing firms. For example, the new plants of continuing firms accounted for only 4.4 per cent of shipments in 1979, while the new plants of entering firms (both plant births and switches) accounted for 16.1 per cent of shipments in 1979. Acquisitions that led to entry were more important than horizontal acquisitions. The shipments share of plants acquired by firms in the same industry was, on average, 3.0 per cent as of 1979, but it was, on average, 10.7 per cent for plants acquired by firms outside the industry.

In summary, the long-run 4-digit industry data reveal the cumulative effect of successive waves of entry over a decade is considerable. On an annual basis, entry is not large. Moreover, a considerable proportion of recent entrants exit the industry. These two stylized facts have all too often been used to infer that the entry process is generally unimportant. However, when entrants are tracked longitudinally, the story changes. Those entrants who do not die in early childhood grow sufficiently to offset the departures.

The Relative Importance of Short- and Long-Run Change Across Firm Size Classes: Focusing on the type and amount of change by size class serves to emphasize both that change occurs in different fashions across the distribution and that, when all forms of change are considered, turnover is pervasive. For this exercise, we focus just on the exit process. A similar picture exists for entry statistics.

In order to show how the intensity of the two forms of exit vary across size classes, the distribution of jobs affected by each was tabulated by size class.[19] The averages of the employment distributions for each class, calculated annually from 1970-1982, are presented in Table 5, columns 1 and 2 respectively, along with the average distribution of employment for firms during this period (column 3).

Employment affected by firms that exited by closing plant is concentrated in the smaller classes; employment affected by divestiture is concentrated in the larger classes. The relative importance of firm exits by closure as opposed to exits by divestiture, when measured by employment affected, is given in column 4. The importance of divestitures increases by size class. It accounts for only some 11 per cent of all employment affected by firm exit in the smallest class; but it accounts for 79 per cent of the total in the largest class.

Examination of the amount of change that occurs by size class in both the short and longer runs, as opposed to the source of change, serves to emphasize the pervasiveness of the change that is occurring. In order to measure the effect of firm growth and decline across size classes, longitudinal data on firms are taken from the LEAP file developed by Statistics Canada (1988). This data base follows firms from 1978 to 1985 and allows comparisons across size classes on a yearly basis as well as between endpoints. Measures derived from the yearly comparisons are referred to as short run and those from comparing the status of a firm in 1978 to 1985 as long run. The exiting firm is classified to a size class in the initial year. Change here is measured in terms of employment. The sample is broken into growing, declining, exiting, and entering firms and the percentage of employment affected by each is calculated. The version of the data base used here has not completely purged its exit category of mergers. Exits will, therefore, include a component that results from the sale of assets.[20]

The distribution of job decline by size class for the manufacturing sector is presented in Table 6. This table compares rates of employment decline due to exit and to contraction in the continuing sector.

Previous studies have found that exits are heavily concentrated in the smaller size classes (OECD, 1985 and 1987). A comparison of rows 1 and 2 to 7 of Table 6 confirms that both in the long and short run, the smaller size classes account for a greater proportion of exits than they do of overall employment. However, when both exits and the decline in continuous firms are combined (rows 5 and 6, Table 6), the distribution of job loss, while still somewhat higher in the smaller classes, is less skewed than before. Moreover, in the long run, the distribution is even less skewed towards smaller size classes than the short run. Concentrating on exit statistics alone or job-loss statistics calculated for short periods will underestimate the extent to which decline is broadly spread across all size classes.

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[19] This was done using consolidated firms. Firms were assigned to a size class based on their size in the base or initial year.

[20] The error rate due to this inclusion is relatively small. See Baldwin and Gorecki (1990, ch.3).

Mobility Measures: Long-run Intra-Industry Dynamics: Rates of growth and decline, as outlined above, show the extent to which absolute changes are taking place in the population of firms. However, they are not ideally suited for capturing the amount of relative size change for several reasons. First, they utilize employment measured at the consolidated firm level. Some of the expansion and contraction measured at this level may come from change in the relative size of industries within which these firms are operating. Analysis at an industry level is required to show what is happening to relative firm size within more narrowly defined markets. Second, in an economy that is growing rapidly, only a few firms may decline in absolute size but there may be substantial changes in relative firm position. Varying rates of positive growth will lead to changes in the rankings of firms within an industry. Discussions of the strength of the competitive process generally have in mind a measure of relative change in market share for evaluating the extent to which some firms supplant others in the struggle for dominance.

To measure change in market share, data at the individual 4-digit industry level were used and shares of firms in 1970 and 1979 were compared. The concept of a firm used in this analysis is the unconsolidated enterprise -- consisting of all establishments in a 4-digit manufacturing industry under common control.[21] Share changes are defined in terms of 4-digit industry shipments.

The index that is used to measure market share change is a dissimilarity index of firm shares between two periods for each firm in the industry.[22] It is defined as one-half the sum of the absolute value of the 1979 share minus the 1970 share for all firms in an industry. This measure captures the market share that is transferred from those firms that are declining to those that are growing in relative importance. It varies from 0 to 100 and, therefore, provides a metric in which the amount or severity of change can be readily measured.

Since the relative size of market share turnover due to entry and exit as opposed to continuing firm expansion and contraction is of interest, three values of the dissimilarity index are calculated. The first captures the amount of market share[23] transfer that is due to entry and exit of firms; the second measures the amount of share transfer within the continuing firm sector alone; the third takes account of all share changes -- for both continuing firms as well as for entrants and exits. The mean values of each of these indices, calculated across 167 4-digit manufacturing industries, are presented in Table 7.

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[21] The category of switches was ignored when change at the level of the manufacturing sector as a whole was being measured.

[22] See Hymer and Pashigian (1962) for an early use of this index to measure instability in an industry.

[23] Market share is calculated using shipments.

Two variants of the index are provided. The first includes only greenfield entry and closedown exit in calculations of the share transfer due to entry and exit.[24] The second also includes entry by acquisition and exit by divestiture in the market share transfer due to entry and exit.[25] Entry by acquisition and exit by divestiture are treated differently in each of these two calculations since there are legitimate differences of opinion as to the importance of these events. On the one hand, these events change the ownership of the firm and new owners may institute new policies and, thus, be regarded as a new force. On the other hand, ownership change may not involve any change in the operating entity and its policies -- only a change in the legal entity. Since, *a priori*, there is uncertainty as to the appropriate treatment that should be accorded this form of entry and exit, the share mobility measure was calculated twice -- once with acquisition and divestiture included as entry and exit; once with it being excluded.[26]

In the long run, the amount of share change from all sources is substantial. Consider first the values of the index when entry and exit by acquisition and divestiture are excluded. Greenfield entry and closedown exit lead to an average of 20 points of market share being shifted from declining to growing firms over the decade. A somewhat lower market share -- some 16 points -- is transferred as continuing firms change relative position. The total shift of 36 percentage points is one-third of the maximum.

When acquisition entry and divestiture exit are considered as entry and exit, the amount of share transfer due to entry and exit increased by a half -- from 20 to 30 per cent. In total, 44 per cent of market share is shifted from one group of firms to another when acquisition entry and divestiture exit are included in the total.

Concentration and Mobility: The picture that mobility statistics give then is one of substantial change in the underlying firm size distribution that is taking place as entry, exit, growth and decline occur. By itself, these data are revealing. Concentration statistics yield a very different picture of the world. They tend to remain relatively constant and, therefore, give the impression of a static universe. While it is possible to find some movement in these indices, the amount of change is small over a decade relative to what is taking place within each industry.

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[24] Entry and exit due to acquisition is not counted as an entry or exit in this version. Share changes in the firm that was acquired are included in the share change associated with continuing firms.

[25] In this formulation, the share change for divested firms is set equal to 1970 share; for acquired firms, it is set equal to 1979 share.

[26] The effect of mergers is dealt with in Baldwin and Gorecki (1989c)

It still, of course, may be the case that concentration changes that do take place are strongly related to the turnover that is occurring within an industry and, therefore, these changes adequately summarize the dynamics of change. To test this, all 167 4-digit industries were ranked on the basis of the amount of concentration change -- using the difference between 1979 and 1970 four firm concentration ratios. The industries were then grouped equally into 8 classes on the basis of the amount of concentration change and the average turnover ratios for entry and exit and for continuing firms (as defined in column 1 of Table 7) were calculated for each group. These are plotted in Figure 4 where the groups are arranged in ascending order of concentration change -- with the leftmost observations representing decline in concentration and the rightmost points representing increases in concentration. There is no simple linear relationship between the turnover measures and changes in concentration. If anything, there is a U-shaped relationship between total turnover and concentration change. It does appear that where concentration fell most, turnover from entry and exit was largest; where concentration increased most, turnover was greatest in the continuing sector. But it also the case that where there was virtually no concentration change, there was also considerable turnover. Concentration change may be indicative of underlying turnover; lack of concentration change is not. It is, therefore, best to concentrate directly on the amount of internal mobility than to rely on concentration measures which provide a misleading picture of the amount and type of change taking place within an industry.

5.0 CONCLUSION

Concentration statistics have long provided the primary focus for studies of market structure. Mobility statistics have garnered less attention. Concentration statistics are designed to capture the extent to which firms are few in number and unequal in size. They are not meant to describe the extent to which there is substantial growth and decline in existing firms and a change in firm rankings. Nor do they capture the extent of entry and exit. They will only capture change to the extent that the overall firm size distribution also changes.

By way of contrast, mobility measures, by focusing directly on movement within the size distribution, provide a direct and more comprehensive measure of change and, therefore, of the intensity of competition. The mobility measures developed here examine both the entry and exit process as well as the rise and fall of incumbents. Over the 1970s, firm exits via plant closure, when calculated at the level of the manufacturing sector as a whole, accounted for 10 per cent of 1970 employment; employment reductions in declining firms accounted on average for another ten per cent. When market share transfer is calculated at the individual 4-digit level, a full one-third of market share on average was transferred from exits and contracting firms to entrants and growing firms over the decade. In addition there were substantial ownership changes that led to exit of firms via divestiture and entry via plant acquisition. This indicates that substantial change occurred within industries, despite the existence of relatively constant concentration measures.

The mobility statistics then place the amount of change in the system in quite a different light than do the concentration statistics. Much of the applied work on the latter has tried to capture influences that were suspected of having more relevance to performance studies than just the percentage of the market accounted for by the top 4 firms. But in the end, this line of research was distinguished by rapidly diminishing marginal benefits. The mobility measures, by way of contrast, are a direct measure of the effects of rivalry and provide a richer picture of the results of competition. It is time they were used more widely to help evaluate the state of competition at the industry level.

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Table 1

The Relationship Between 1970 and 1979, Four-Firm Concentration Ratios, Manufacturing Sector, 167 4-digit Industries, Canada

		CR4, 1979				
	Frequency Percent Row PCT Col PCT	**0.00-0.249**	**0.25-0.499**	**0.50-0.749**	**0.75-1.00**	**Total**
CR4 1970	0.00-0.249	24 14.37 88.89 92.31	3 1.80 11.11 4.76	0 0.00 0.00 0.00	0 0.00 0.00 0.00	27 16.17
	0.25-0.499	2 1.20 3.33 7.69	51 30.54 85.00 80.95	7 4.19 11.67 14.58	0 0.00 0.00 0.00	60 35.93
	0.50-0.749	0 0.00 0.00 0.00	9 5.39 20.45 14.29	31 18.56 70.45 64.58	4 2.40 9.09 13.33	44 26.35
	0.75-1.00	0 0.00 0.00 0.00	0 0.00 0.00 0.00	10 5.99 27.78 20.83	26 15.57 72.22 86.67	36 21.56
Total		26 15.57	63 37.72	48 28.74	30 17.96	167 100.00

Table 2

The Importance of Entry, Exit, Growth and Decline for Firms in the Canadian Manufacturing Sector Between 1970 and 1982

Year	Rates of Entry and Incumbent Expansion			Rates of Exit and Incumbent Contraction		
	Entry		Expansion	Exit		Contraction
	Greenfield	Acquisition		Closedown	Divestiture	
			%			
1970-71	1.2	0.4	5.2	1.1	0.2	6.1
1971-72	1.0	0.7	8.5	0.9	1.5	4.7
1972-73	1.1	0.4	9.4	0.6	0.9	3.9
1973-74	1.2	2.4	8.2	0.9	3.0	4.9
1974-75	0.8	0.2	5.7	0.9	1.6	7.6
1975-76	0.4	0.4	6.7	1.2	0.6	5.8
1976-77	0.3	0.4	6.7	1.5	0.6	6.8
1977-78	1.2	2.4	9.0	1.6	3.3	5.6
1978-79	0.7	1.8	10.5	1.0	2.4	5.6
1979-80	1.2	1.9	7.0	1.2	2.8	7.9
1980-81	0.6	1.2	13.4	1.4	5.3	5.9
1981-82	1.1	1.0	3.6	1.7	2.0	10.6
Mean	0.9	1.1	7.8	1.2	2.0	6.3

Note: All rates use employment and are calculated relative to base year employment in the manufacturing sector. See definitions in text.

Source: Special Tabulations: Business and Labour Market Analysis Group, Statistics Canada

Table 3

The Cumulative Importance of Entry, Exit Expansion and Contraction of Firms in the Canadian Manufacturing Sector, 1970-81

Period	Entry Rate		Expansion Rate	Exit Rate		Contraction Rate
	Greenfield	Acquisition		Closedown	Divestiture	
			%			
Panel A	**Cumulative Change from Comparing Endpoints**					
1970-76	5.1	4.7	19.1	5.3	7.3	10.5
1975-81	6.1	9.0	23.1	7.8	12.7	10.4
1970-81	10.9	14.6	27.2	10.5	17.7	11.0
Panel B	**Implicit Annual Rates from Comparing Endpoints**					
1970-76	0.8	0.8	3.0	1.0	1.3	1.8
1975-81	0.9	1.4	3.5	1.3	2.2	1.8
1970-81	0.9	1.3	2.2	1.0	1.8	1.1
Panel C	**Average Annual Rates Within Periods**					
1970-76	0.7	0.7	7.3	0.9	1.3	5.5
1975-81	1.0	1.4	8.9	1.3	2.5	6.2
1970-81	0.9	1.1	8.2	1.1	2.0	5.9

Note: All rates use employment and are calculated relative to base year employment in the manufacturing sector.

Source: Special Tabulations: Business and Labour Market Analysis Group, Statistics Canada

Table 4

Average Share of Number of Establishments and of Shipments Across 167 4-digit Canadian Manufacturing Industries for Various Entry and Exit Categories, Cumulative 1970-79

Firm Category	Share of Number of Establishments		Share of Shipments	
	1970	1979	1970	1979
1) All Firms	100.0	100.0	100.0	100.0
2) All Entrants	.....	33.2	.....	26.8
i) by plant birth	.....	18.8	.....	11.5
ii) by Acquisition	.....	8.7	.....	10.7
iii) by plant switch	.....	5.6	.....	4.6
3) All Exits	39.8	.....	30.8	.....
i) by plant closing	24.6	.....	13.3	.....
ii) by divestiture	10.0	.....	12.7	.....
iii) by plant switch	5.2	.....	4.9	.....
4) All Continuing Firms	60.2	66.8	69.1	73.2
i) continuing plants	55.3	59.2	63.4	65.0
ii) divested	0.6	.....	1.1	.....
iii) acquired	.....	2.2	.....	3.0
iv) plant closures	3.8	.....	3.8	.....
v) plant births	.....	4.6	.....	4.4
vi) plant switches	0.5	0.7	0.8	0.9

Notes:
1) The sample consists of a reduced set of firms that report extensive information to the Canadian Census of Manufactures. A discussion of the data base can be found in Baldwin and Gorecki(1989b).
2) Entrants are firms that enter an industry between 1970 and 1979 and are extant in 1979.
3) Exits are those firms in 1970 that are no longer in the industry in 1979.
4) Continuing firms and establishments exist in the industry in both 1970 and 1979.
5) Plant switches are those plants that are reclassified from one industry to another because the principal product has changed.

Source: Special Tabulations: Business and Labour Market Analysis Group, Statistics Canada

Table 5

Distribution of Employment Loss Associated with Firm Exits for Canadian Manufacturing, By Size Class, 1970-82

(percentage)

Employment Size Class	Method of Exit		All Employment in Continuing Firms	Percentage of Employment in All Exits Accounted for by Divesting Firms
	Divestiture	Closedown		
	(Mean per cent value of the distributions)			
1-19	1.8 (0.3)	21.8 (1.6)	4.2 (0.1)	11.0 (1.2)
20-99	17.8 (2.8)	41.7 (1.7)	14.8 (0.1)	38.0 (2.6)
100-499	32.7 (3.9)	22.4 (1.3)	18.9 (0.1)	68.0 (3.0)
500+	47.7 (6.2)	14.1 (3.0)	62.1 (0.3)	79.0 (7.2)
All	100.0	100.0	100.0	60.0 (5.0)

Notes:
1) The data were calculated for each year between 1971 and 1982 and then averaged. Continuing firms possessed plant in an industry in each of the base and terminal years.
2) The standard error of the mean taken across the years 1971-82 is presented in brackets.

Source: Special Tabulations: Business and Labour Market Analysis Group, Statistics Canada

Table 6

The Distribution Across Size Classes of Job Loss Due to Exits and Declining Firms Between 1978 and 1985 for the Canadian Manufacturing Sector

Category	Size Class (employees)					
	<5	5 to 19	20 to 49	50 to 99	100 to 499	500+
Exits						
1) Long run	4	12	15	15	33	21
2) Short run	6	11	13	12	31	26
Declining						
3) Long run	1	5	7	6	19	62
4) Short run	4	9	11	10	23	45
Total						
5) Long run	3	8	11	11	26	42
6) Short run	4	9	11	10	25	41
Distribution of Employment in 1978	1.6	5.6	7.8	7.5	21.5	56.0

Note: The long-run estimates are calculated by comparing a firm's position in 1978 and 1985. The size class is assigned on the basis of 1978 status. The short-run estimate is calculated using adjacent years form 1978 to 1985 and then by averaging the results.

Source: Special Tabulations: Business and Labour Market Analysis Group, Statistics Canada.

Table 7

Average Share Change Due to Turnover of Entrants, Exits, and Continuing Firms Over the Period 1970-1979

(per cent of total shipments)

Cause of Turnover	Entry and Exit due to acquisition or divestiture omitted[1]	Entry and Exit due to acquisition or divestiture included
Entry and Exit[2]	20	30
Growth and Decline in Incumbents[3]	16	14
Total	36	44

Notes: 1) For the first column, all firms that were acquired or divested were treated as continuing during the decade and share changes therein included in row 2; in the second column, these firms are treated as entrants and exits and included in row 1 as described in note 2.
2) Share change is calculated as one-half the sum of entry plus exit for each industry and then averaged across 167 4-digit manufacturing industries.
3) Share change is one-half the sum of the absolute value of the difference between the shares of all continuing firms measured in 1970 and 1979.

Source: Special Tabulations: Business and Labour Market Analysis Group, Statistics Canada

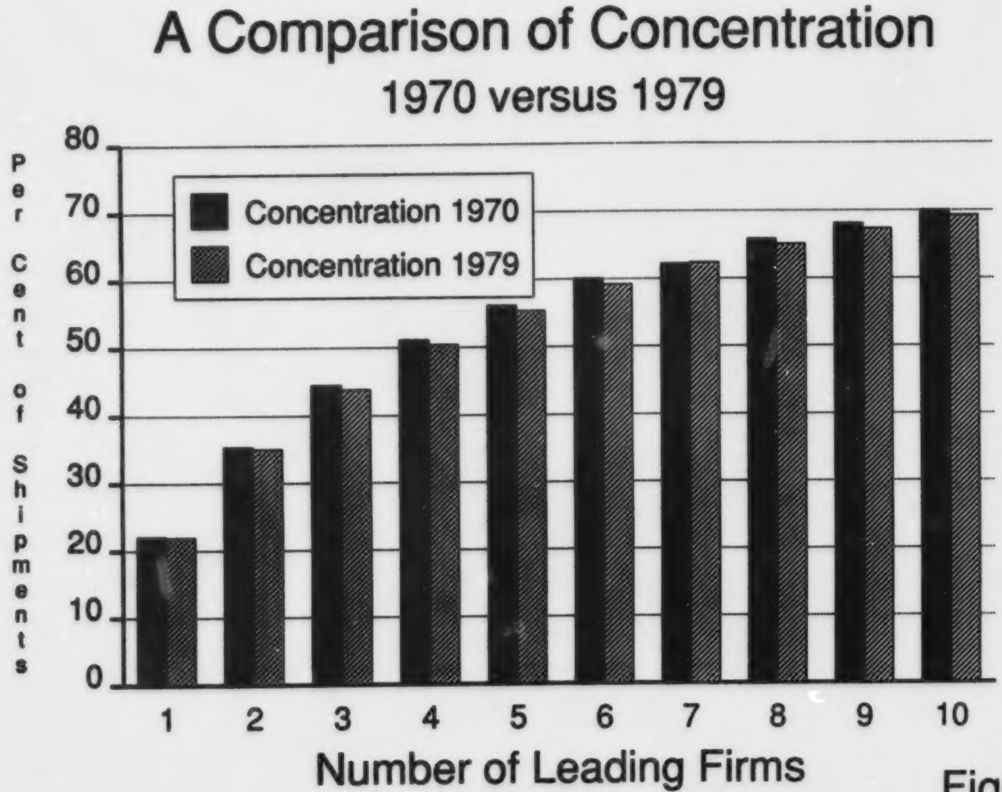
A Comparison of Concentration
1970 versus 1979
Per Cent of Shipments
80
70
60
50
40
30
20
10
0
Concentration 1970
Concentration 1979
1
2
3
4
5
6
7
8
9
10
Number of Leading Firms

Figure 1

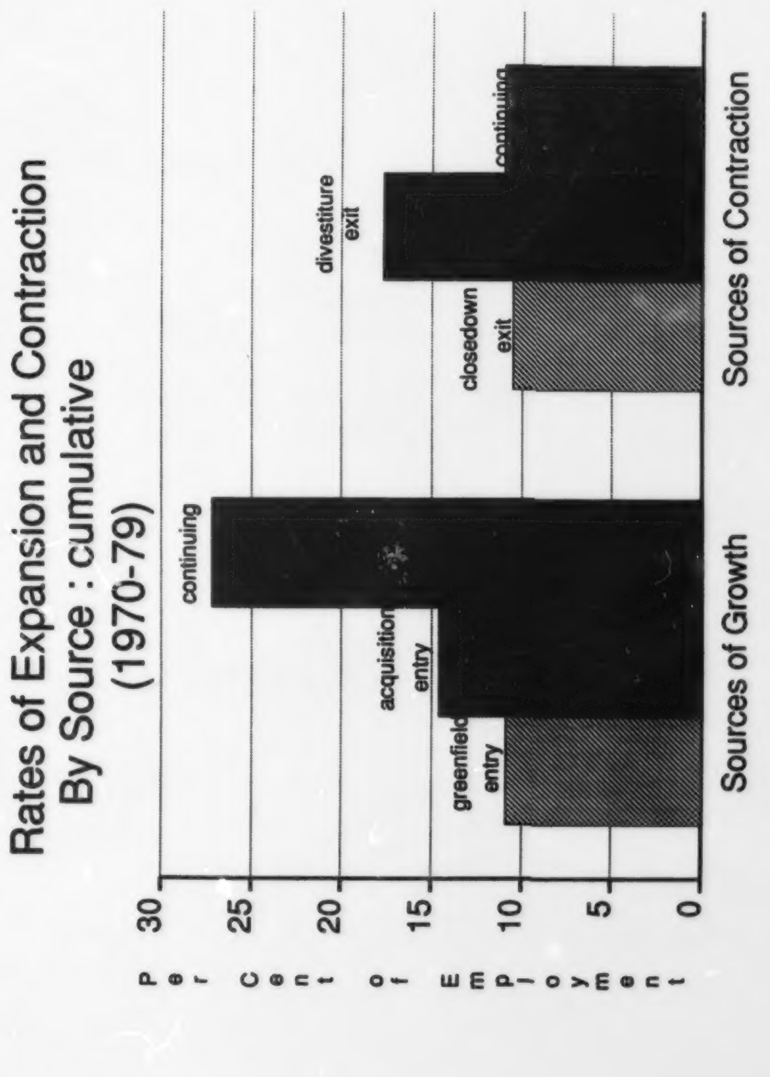
Rates of Expansion and Contraction
By Source : cumulative
(1970-79)
Per Cent of Employment
30
25
20
15
10
5
0
greenfield entry
acquisition entry
continuing
Sources of Growth
closedown exit
divestiture exit
continuing
Sources of Contraction

Figure 2

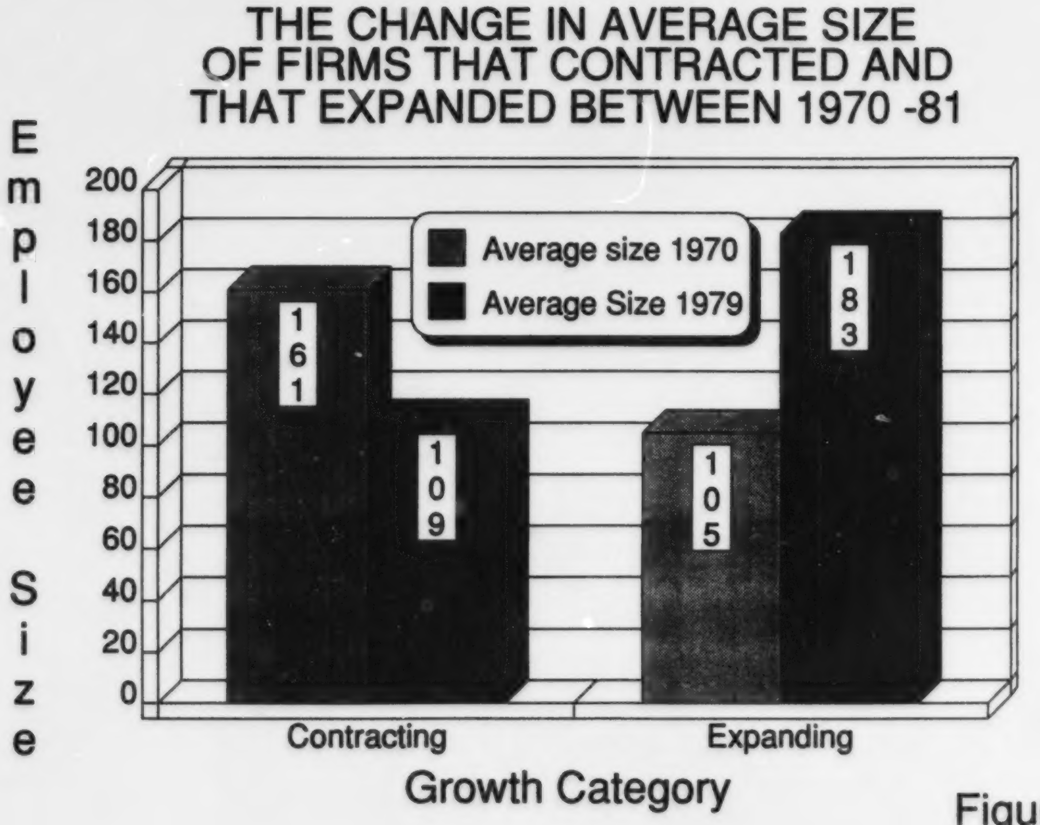
THE CHANGE IN AVERAGE SIZE OF FIRMS THAT CONTRACTED AND THAT EXPANDED BETWEEN 1970 -81
Employee Size
200
180
160
140
120
100
80
60
40
20
0
Average size 1970
Average Size 1979
161
109
105
183
Contracting
Expanding
Growth Category

Figure 3

THE INTENSITY OF TURNOVER
VERSUS CHANGE IN CONCENTRATION
(1970-1979)

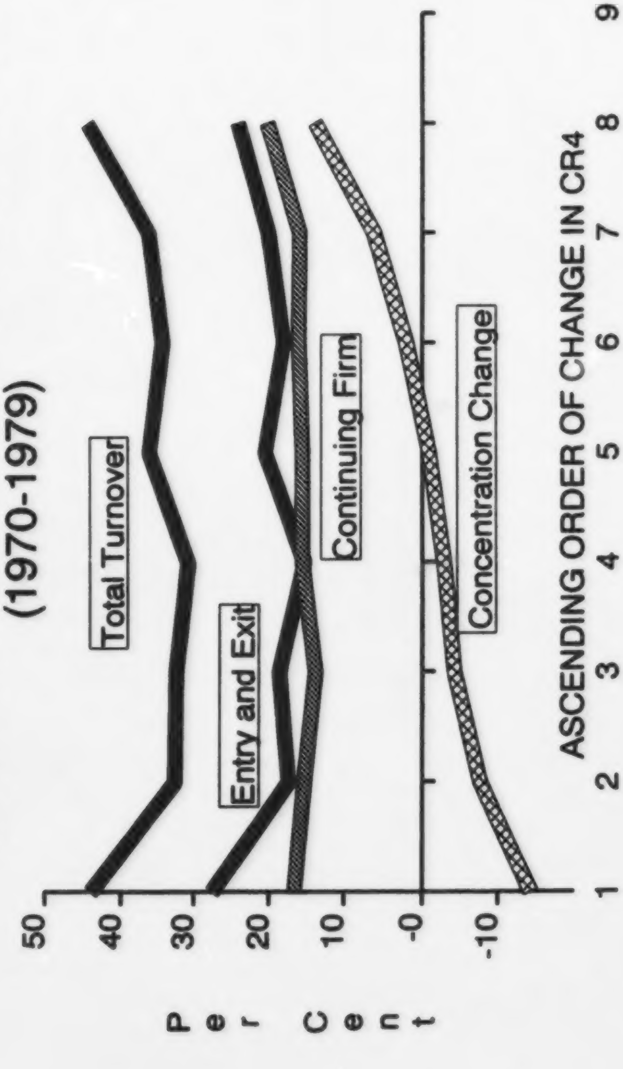

FIGURE 4

Chapter 13

MONOPOLIZATION AND ABUSE OF DOMINANT POSITION: THE UNANSWERED QUESTIONS

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1.0 INTRODUCTION

This paper was initially commissioned to answer the question, "what is the status of sections 78 and 79 of the *Competition Act*, concerning monopolization and the abuse of dominant position." The new *Competition Act* in 1986 dropped the old criminal offence of "monopoly," replacing it with a civil review process.[1] The requirement of proving "detriment" was replaced with what was thought to be a less difficult test of establishing "substantial lessening of competition" (see Appendix A).

Given the wave of mergers and acquisitions which has characterized the late-1980s, and the already high degree of market concentration found in the Canadian economy, it was assumed that the monopolization and dominant position sections would be the subject of a great many more cases than the old monopoly provision had in the past.

A larger number of cases were also expected because of the interrelationship between the law on monopolization, and that on mergers. As pointed out by Bruce McDonald and other observers,[2] the more effectively that Canadian law deals with abuses of market power, the more liberal the Competition Tribunal can be about permitting mergers. As discussed in the paper by Calvin B. Goldman (in Part 9 of this volume), during or even beyond the three-year merger monitoring period provided in the Act, the abuse of dominant position provisions can be used to find a remedy where the merged entity is engaging in anticompetitive behaviour.

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[1] On the evolution of the provision, see Rosenbluth (1979), Skeoch with McDonald (1976), Stanbury (1978) (1984), and Waverman (1985). On the EC cases, see Grover (1986).

[2] See McDonald (1987), Anderson and Khosla (1987), Stanbury (1986), Martin and Martin (1987).

The effectiveness of the sections in preventing the abuse of market power are also argued to reflect back on the types of section 93 and 96 "efficiency offset" risks that the Competition Tribunal might be willing to accept in evaluating mergers.

In spite of all the good arguments, very little has happened in the "monopolization and dominant position" area since the *Competition Act* was passed. Indeed, if I stuck to the question, "what is the status of sections 78 and 79 now" this paper would be very brief. The answer is, there is no "new" status, because in the three years since the "monopoly" section was replaced, there have been no Competition Tribunal decisions on "abuse of dominant position."

There is one case in process, *NutraSweet*, which at the time of writing has been filed with the Tribunal, and which should when decided, answer most of the questions that this paper was commissioned to consider.[3]

A second case, involving the Canadian telephone directory "yellow pages" industry, became public when the Director filed a brief outlining its substance before the Canadian Radio Television and Telecommunications Commission in 1988. This case has not been filed with the Tribunal.[4] A third case, concerning a refusal by Xerox Canada to supply copier parts, might have been filed as an abuse of dominant position case but instead was filed in November of 1989 only on the basis of Xerox' refusal to supply.[5]

This paper looks at the *NutraSweet* fact situation and filing, and some of the related case law and analysis in Canada, the United States, and the EEC in terms of the contributions it makes to our understanding of the Director's approach to sections 78 and 79.

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[3] This paper was written before the *NutraSweet* case was decided in favour of the Director on October 4, 1990 (1990) 32 C.P.R. (3d) 1. See Thompson (1991), Hunter (1990), Goldman et al. (1990).

[4] The background to the Canadian telephone directory industry is set out in "Submission of The Director of Investigation and Research, Competition Act, to the Canadian Radio-Television and Telecommunications Commission, In the Matter of CRTC Telecom Public Notice 1988-46, Bell Canada Provision of Telephone Directory Data Base in Machine Readable Form, n.d." (submitted September, 1988).

[5] "In the matter of an application by the Director of Investigation and Research under Section 75 of the *Competition Act*, R.S.C. 1985, C-34, as amended, in the matter of Xerox Canada," filed with the Registrar, Competition Tribunal in November, 1989. On November 2, 1990 Xerox Canada was ordered by the Tribunal to accept Exdos Corporation as a customer. See *Canadian Competition Policy Record*, Vol. 11(4), 1990, pp. 2-4.

2.0 THE NUTRASWEET CASE[6]

The NutraSweet Company is a Delaware Corporation. Formerly owned by G.D. Searle & Co, it was purchased by the Monsanto Company in 1986. It produces and sells an artificial sweetener branded NutraSweet, a commodity chemical which is a form of the generic di-peptide aspartame. Aspartame is the only intense sweetener (about 180 times sweeter than sugar) currently approved for widespread use in Canada. NutraSweet sells over 95% of all aspartame used in Canada.

About 60% of the market for aspartame in Canada is with Coca-Cola and Pepsi Cola in the soft drink industry. Aspartame is also used in powered foods, breakfast cereals, chewing gum, breath mints, and in a variety of other food products. The total Canadian annual market for aspartame is about 400,000 kilograms, with a wholesale value of over $25 million.

The Canadian patent for aspartame expired in July of 1987. The U.S. patent, which was also to expire in 1987, was extended by Congress for five years as part of a U.8. Food and Drug Administration package which changed the regulations governing generic drug approvals in the U.S., and extended some patent periods as compensation to existing patent holders. Aspartame was the only non-prescription product to have its patent life extended under this package. The U.S. is currently the only country in the world where aspartame is patent protected.

A competing company called Tosoh Canada Ltd. is also engaged in distributing aspartame in Canada. Tosoh's aspartame is manufactured by the Holland Sweetener Company in the Netherlands.

The only other company in the world with the capability to produce aspartame from single-use plants (thus at low prices), and in commercial quantities is said to be Ajinomoto & Co. Ltd. in Japan. NutraSweet had entered into a cross licensing agreement with Ajinomoto whereby it has sole North American marketing rights for any aspartame manufactured by Ajinomoto. Thus, Ajinomoto does not compete with NutraSweet for sales of aspartame in Canada. NutraSweet imports its aspartame from the United States. There is no manufacture of aspartame in Canada.

Tosoh filed a complaint with the Bureau of Competition Policy in February 1988, alleging that NutraSweet is engaged in anti-competitive practices in marketing aspartame in Canada, and is effectively preventing Tosoh from gaining market share. Specifically, Tosoh alleged that NutraSweet had engaged in exclusive dealing, tied selling, and abuse of dominant position.

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[6] *DIR v. The NutraSweet Company*, CT-2-89 (May, 1989). (In The matter of an application by the Director of Investigation and Research under Sections 79 and 77 of the *Competition Act*, R.S.C. 1985, C-34, as amended, in the matter of The NutraSweet Company, filed with the Registrar, Competition Tribunal on May 31, 1989. A Response on behalf of the NutraSweet Company, denying most of the allegations in the Director's Application, was filed with the Tribunal on July 25, 1989.

In his Application to the Tribunal in May of 1989 (15 months after the original complaint), the Director submitted that NutraSweet completely controls the supply of aspartame throughout Canada, that such supply of aspartame constitutes a class or species of business; that NutraSweet is engaging in a practice of anti-competitive acts within the meaning of section 78; and that such practices have had, are having, and are likely to have the effect of lessening competition substantially in the supply of aspartame in Canada.

The Director argued that NutraSweet's various acts constituted anti-competitive acts within the meaning of Section 78 of the Act. The first "act" is that NutraSweet uses the bargaining strength of its United States patent position to enter into world-wide exclusive supply contracts of several years duration, with the parent companies of the largest purchasers of aspartame in Canada. It is alleged that NutraSweet is leveraging its bargaining strength, built on U.S. patent protection, to secure worldwide contracts with Coca Cola, Pepsico, and other U.S.-based multinationals. Leveraging is the use of monopoly power held in one market, to accentuate or leverage market position in a second market. The *NutraSweet* reference is perhaps the first use of a leveraging argument in a Canadian competition policy case.[7] These contracts are claimed to preclude such customers from purchasing any supply of aspartame in Canada from suppliers other than NutraSweet. The practice forecloses about 60% of the Canadian market for manufactured aspartame. This it is argued, substantially lessens competition.

The second alleged anticompetitive "act" is that NutraSweet has used its dominant market position in Canada to extract contractual terms which tied its customers to purchase their entire supply of aspartame from NutraSweet. This also is argued to substantially lessen competition. The contractual terms involved seem to have included:

(a) conditioning the supply of aspartame on the use of the NutraSweet trade mark on the customer's packaging, thus requiring that NutraSweet be the sole sweetener in the customers' products;

(b) conditioning the supply of aspartame on the use of an exclusive supply clause, where customers are obligated to purchase their entire supply of aspartame from NutraSweet, and;

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[7] There are several cases of leveraging under Section 2 of the *Sherman Act*. An interesting case, and perhaps the most recent is *Kerasotes Michigan Theatres Inc. v. National Amusements, Inc.*, 854 F. 2d 135 (6th Cir. 1988). Dominant firm leveraging was found to be a violation of section 2 of the *Sherman Act* in *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F. 2d (2d Cir. 1979), cert. denied, 444 U.S. 1093 (1980).

(c) conditioning the supply of aspartame on the successful completion of world-wide exclusive dealing contracts.[8]

The third "act" is that pricing of NutraSweet's aspartame is structured using fidelity rebates pursuant to which customers are forced to purchase their entire supply of aspartame from NutraSweet in order to obtain a competitive price.[9]

The fidelity rebates include use of a trademark display allowance; volume discounts structured to require customers to purchase their entire supply of aspartame from NutraSweet; providing free products and money to customers for co-operative marketing programs involving only products which contain NutraSweet's aspartame as the sole sweetening ingredient; and rebates for each kilogram of aspartame which a customer persuades its co-packers to purchase from NutraSweet rather than from a competitor.

These pricing conditions are argued to foreclose portions of the Canadian market to competition by inducing customers to refrain from using any other sweetener in conjunction with NutraSweet, and therefore prevent or substantially lessen competition.

The fourth "act" is that NutraSweet has used bargaining strength from the existence of the U.S. patent and uncertainty about Canadian supply, to require written long term contracts from many of its customers. These contracts extended NutraSweet's dominant market position beyond the expiration of the Canadian patent (and could in future extend it beyond the expiration of the

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[8] There is a distinct similarity between what is alleged in NutraSweet, and the fact situation in the United Shoe Machinery case, *United States v. United Shoe Machinery Corporation*, 110 F. Supp. 295 (D.Mass. 1953), a case under Section 2 of the *Sherman Act* where the issue was whether otherwise legitimate business practices might, when practiced by a dominant firm (in United's case, with a 75% market share), erect overwhelming barriers to entry into the market for shoemaking equipment. United Shoe Machinery distributed its equipment only through long term leases, maintained its leased machinery without charge (thus deterring independent service organizations), gave discounts on new equipment if it replaced their old equipment, and required lessees to use United's equipment to full capacity if work were available, before competitors machinery could be utilized. The court found that the combination of practices limited actual competition, and deterred potential competition. See also *CASS Student Advertising Inc. v. National Educational Advertising Service*, 2 Trade Cases (N.D. Illinois) 667, 1976, an action under Sections 1 and 2 of the *Sherman Act* where the court found that legitimate business practices can become monopolistic practices where dominant market power is present.

[9] A very similar case of fidelity rebates occurred with a Hoffman-La Roche practice in Europe of calculating purchaser discounts based on total purchases of vitamins only if virtually all vitamin requirements were purchased from Roche. The European Court found this to be a practice of discriminatory pricing and an abuse of dominant position under article 86 of the *Treaty of Rome*. *Hoffman-La Roche*, E.C.R. 461 (1979). For similar findings see *Nederlandsche Banden Industries Michelin v. Commission*, E.C.R. 3461 (1983) and *Napier Brown v. British Sugar*, Commission decision of July 18, 1988. Generally, see Grover (1986).

U.S. patent), thus preventing or substantially lessening competition in Canada.[10]

The fifth "act" is that NutraSweet has entered into at least one contract that permitted its customers through a "meet or release" clause to solicit competitive bids for the supply of aspartame in Canada. The contract allowed NutraSweet the option of meeting any lower price offered by a competitor, or releasing the customers from the contractual obligation to purchase a quantity of aspartame. The quantity "released" would be equal to the quantity governed by the competitive offer. This is referred to as an "English clause."[11] NutraSweet also had an amended contract with a customer which contained an "extended release clause." The clause would come into effect following the exercise of an English clause by any equally large customer. The second customer would be released from its contractual obligations for a similar amount of product as was involved in the first customer's "English clause." The Director argued that the "English clause" and "extended release clause" provided NutraSweet with market transparency, permitting it to know what prices were being offered by competitors, and permitting it to decide to meet or not meet those prices at its own sole discretion.

The sixth "act" is that NutraSweet entered into "most favored nation" agreements with its customers whereby it agreed that the price it charged would be adjusted to equal the lowest price it charged to any other customer. It is argued that this "most favored nation" clause lessened competition in the supply of aspartame.

The seventh "act" is that NutraSweet used its trade mark, co-operative marketing programs, and the provision of free aspartame as parts of an overall strategy designed to artificially extend its dominant market position after its Canadian patent had expired, thus substantially lessening competition.

The eighth "act" is that NutraSweet sold aspartame in Canada at a price below its acquisition cost or below its long run average cost, with the result that competition was substantially lessened.[12]

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[10] There are several U.S. cases dealing with attempts to artificially extend patent terms, finding them in violation of Section 2 of the *Sherman Act*. See *Agrishell, Inc. v. Hammons Products Company*, 479 F. 2d. (8th Cir. 1973) at 269.

[11] The existence of an English clause with the resulting necessity to undercut a competitor's price rather than just meet it, is characterized as a restraint of trade in *International Salt Co. Inc. v. United States*, 332 U.S. 392.

[12] The first predatory pricing conviction in Canada, and a case that sets out in some detail an analysis of the elements of predatory pricing, is *R. v. Hoffman-LaRoche Ltd.*, 109 D.L.R. (3d) 5 (1980). See also the discussion in McFetridge and Wong (1985, p. 685). A discussion of the European Commission position on predatory pricing is found in the *Napier Brown* case, *supra*, note 9, where the Commission found that pricing cutting below the point where an equally efficient seller of sugar could survive was an abuse if practiced by a dominant firm.

The ninth "act" is that NutraSweet had lowered prices throughout Canada as a way of raising barriers to entry into the aspartame market, thus substantially lessening potential competition. Specifically, NutraSweet was alleged to have tailored individual prices, discounts, rebates and allowances for each customer, to prevent new entrants from gaining a foothold in the market.[13] The result is claimed to be prices which vary both across and within industries, with price differentials which do not reflect any increase in costs, or savings because of volume purchased.

In 1986 the European Commission received complaints about NutraSweet's marketing practices, from the Holland Sweetener Company and from Angus Fine Chemicals Limited, who were planning on competing with NutraSweet in the sale of aspartame. The complaints contained elements of the same practices as described in the Director's filing. Holland and Angus alleged that worldwide exclusive contracts entered into by NutraSweet, Coca Cola Company and Pepsico Inc. infringed Article 85 of the *Treaty of Rome*. Negotiations followed, and NutraSweet agreed to amend the contracts such that exclusive supply arrangements no longer applied to the European Community. Instead, Coke and Pepsi would be required to purchase a fixed quantity of aspartame from NutraSweet over a two year period, with the quantity set such that newcomer firms have the opportunity to sell within the Community. However it should be noted that the European Commission challenged the exclusionary clauses in the Coca Cola and Pepsi agreements under Section 85, of the *Treaty of Rome*, dealing with exclusive dealing and unreasonable restraint of trade. The Commission ruled against the exclusive dealing provisions in the two contracts, but did not consider the abuse of dominant position question. In 1987 there was an additional complaint to the European Commission on the abuse of dominant position issue, alleging that NutraSweet's practices violated Article 86 of the *Treaty of Rome*.

3.0 UNANSWERED QUESTIONS ON SECTIONS 78 AND 79

Sections 78 and 79 appear under the heading "Abuse of Dominant Position," and are generally referred to under that phrase. In fact, the phrase "abuse of dominant position" does not appear in those sections of the *Competition Act*. However "abuse of dominant position" is a good descriptor, in that it parallels the language in Article 86 of the Treaty of Rome, and the terminology used in Europe, Australia, and other jurisdictions.

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[13] Is the introduction of lower prices only for customers where competition is present, analogous to the use of fighting brands as found in Eddy Match? *Eddy Match Co. v. The Queen*, 109 C.C.C. 1 (1953), at 23-24. But see Waverman's (1985) critique. Section 78(d) of the Act discusses "the use of fighting brands introduced selectively on a temporary basis to discipline or eliminate a competitor". Fighting brands involve a form of cross-subsidization of "competitive" customers with less competitive ones. An analogous form of cross-subsidization of low prices with higher ones was found to be an abuse of dominant position in the European Commission finding in *Engineering and Chemical Supplies v. AKZO Chemie BV.*, 85 EEC 609.

Sections 78 and 79 refer to "Persons" who "substantially or completely control, throughout Canada or any area thereof, a class or species of business," and who engage in "a practice of anti-competitive acts" that "has had, is having, or is likely to have the effect of preventing or lessening competition substantially in a market."

The three elements of "substantial control," "anticompetitive acts," and "lessening competition substantially" must be shown by the Director to exist on a balance of probabilities. The unresolved issues in the sections involve their scope and possible application.[14] The issues that arise, illustrated well by the cases above, include definition of market, dominance and joint dominance, anti-competitive acts, what "substantially" means, and the range of prohibition orders and other remedies.

It is tempting to look to U.S. jurisprudence for answers to some of the questions that arise in these cases, and in particular to look to Section 2 of the *Sherman Act*. However Section 2 is much broader in scope than Sections 78 and 79 of the *Competition Act*. The section 78 and 79 abuse provisions are roughly analogous to the "monopolization" provisions in Section 2. Section 2 also deals with attempts to monopolize and with combinations or conspiracy to monopolize. The sections of the *Competition Act* focus not on an attempt to achieve a dominant position, but on the nature of the activities of persons with such a position.

There may also be some useful U.S. jurisprudence under section 5 of the *Federal Trade Commission Act*, which makes unlawful unfair acts or practices, or methods of competition. The issue of shared monopoly has arisen in section 5 cases such as the ready-to-eat cereals and *Ethyl Corporation* cases.[15]

3.1 Definition of Market

The first requirement under Section 79 appears to be one of market definition; the "area," and "class and species of business" for which substantial or complete control exists. (Is a class and species of business the same as a "market" used in subsection (c)? Is this control of a commodity or product, or control of a market?)

The required definition probably refers to control of a market; the classic "relevant market" analysis which occurs in every merger case to determine the denominator of "all competitive business" against which a numerator of "business controlled" can be compared. The whole area of relevant market analysis in merger cases is described at length in Paul Crampton's article (in Part 3 of this volume).

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[14] See also Stanbury (1986), McDonald (1987), Anderson and Khosla (1987).

[15] *Re Kellogg Company et al.*, 42 A.T.R.R. 182 (1982); *Ethyl Corporation v. F.T.C.*, 729 F. 2d 128 (2nd Cir. 1984). In both cases the F.T.C. was ultimately unsuccessful in establishing shared monopoly, but there is extensive discussion in each of the economic circumstances in which they were willing to find "conscious parallelism plus" behaviour as being shared monopoly.

However, in a dominance case, "relevant market" may be quite different from the relevant market in a merger case. In a merger case, determination of relevant market looks at goods or services which might be substitutes in use (even if they are not used at present), interchangeability in use, relative price, physical similarity, unique qualities of the product or service, interchangeability of production equipment, and at poised entry and barriers to entry. For geographic markets, one looks at market and product characteristics, specialized channels, potentially interchangeable channels, and at submarkets.

The extreme in defining geographic markets may be the "diversion approach" of now Judge Richard Posner (1976), who argued that when a distant seller, domestic or foreign, has some sales in a local market, then all of the sales of that supplier, wherever executed, should be considered a part of the local geographic market for purposes of computing the "real" market shares of competitors in that market. The concept (which predates Posner but is best argued by him), is that if a distant firm can sell some units of a product in a local market, they ought to be able to sell many units there at the same cost, since they only have to divert output from other markets. This sort of "open ended" approach to market definition may have limited application in the area of mergers, but arguably is not applicable in looking at present detriment flowing from current market structure.

A more appropriate approach in section 78 and 79 cases is a narrower one where definition of a market begins from the factual perspective of the injured party. A relevant market would be based on actual buyer-seller transactions and trade patterns, with the onus on the Director to show how this view of the market is inaccurate.[16]

Use of this market-definition guide has become widespread in the U.S. in monopolization cases, and has been adopted by the National Association of Attorneys General. Their guidelines are the following: "Initially, product markets will be defined as the product or products subject to the restraint including obviously suitable substitutes. The geographic market will be defined by the established patterns of distribution which actually exist in an industry."[17]

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[16] This is close to the Tribunal's approach to relevant market in *Chrysler*, a section 75 refusal to supply case. The Tribunal held that the starting point in market analysis in refusal to supply is the buyer's customers. See D.I.R. v. Chrysler Canada Limited (1989), 27 C.P.R. (3d) 1. For subsequent developments, see *Canadian Competition Policy Record*, Vol. 11(1), 1990, pp. 1-2.

[17] *Vertical Restraints Guidelines*, adopted by the National Association of Attorneys General, December 4, 1985, amended December 8, 1988. The citation is from p. 62. The section goes on to say that: "Utilization of these simple market definition principles will suffice in most cases, i.e. where analysis shows a clearly anticompetitive effect requiring enforcement action or an ambiguous competitive effect or clearly procompetitive effect, resulting in no enforcement action. In such cases a more highly delineated market definition would in all probability not alter the

The *NutraSweet* case does not provide much guidance on the matter of relevant market. The Director submitted that aspartame alone constituted the relevant product market for the purposes of sections 78 and 79, in that it was the only intense sweetener currently approved by Health and Welfare Canada for widespread use in the country. (Saccharin, another intense sweetener, is only sold in drug stores in Canada. Cyclamates are approved for use only in table top sweeteners, a fairly small total market).

The Director submitted that the very reason for aspartame's existence was to provide an alternative sweetening agent for those individuals who either could not tolerate sugar for medical reasons, or did not wish to consume sugar because of its high caloric content. Aspartame is used in chewing gum and breath mints, not because of its low caloric content, but because it does not have the same deleterious effect on teeth as does sugar. It is argued that in every use, products sweetened with sugar do not substitute for products sweetened with aspartame.

The Director submitted that the relevant geographic market for purposes of sections 78 and 79 was Canada, because most or all contracts in the industry treat Canada as a distinct market.

3.2 Dominance and Joint Dominance

The issue of "control" in section 79 relates to market power. Market power has traditionally been defined in terms of an enterprise having the power to raise prices and thus increase profits, without competitors being able to constrain the increase or gain market share because of it. A perhaps more appropriate definition comes from a European Commission case: "The dominant position [discussed in Article 86 of the Treaty of Rome] relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained in the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers, and ultimately of its consumers."[18]

Joint dominance would then be defined as a number of companies engaged in the same business, working formally or informally "as an undertaking" to accomplish the power to behave independently. Joint dominance is almost certainly included in section 79, as the phrasing of 79(1)(a) is very close to the comparable provision in the old section 33, which was interpreted in the *Large Lamps* case to mean that two or more unrelated

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outcome of the analysis but would require unnecessary expenditure of scarce governmental resources. In cases where this analysis yields a determination that the restraint is anticompetitive but the conclusion might change if the market definition were more highly delineated, the principles outlined in the Merger Guidelines will be employed." The Attorneys General approach, and much of the discussion around using "actual market behaviour" approaches in monopolization cases, arises from an article by Harris and Jorde (1983, p. 46).

[18] *United Brands Company v. European Community Commission*, ECR 207, par.65 (1978).

businesses could hold and exercise monopoly power jointly.[19] In *Large Lamps*, Mr. Justice Pennell emphasized that the sharing of dominance came about because of an agreement among the three accused, which took the outward form of identical price lists, a common consignment system, and similar sales plans. He emphasized that the arrangement had gone beyond mere "conscious parallel behaviour," suggesting that the test for joint dominance might still remain something like "conscious parallelism plus," the plus factor being something that reflects overt collusion, or goes well beyond normal business practice (more generally, see Stanbury and Reschenthaler, 1977).

3.3 What Are Anti-Competitive Acts?

A second requirement under section 79, when the relevant market is defined and if "dominance" is found, is to determine whether the controlling person or persons practiced "anticompetitive acts."

What is the meaning of "practice"? The term is used in various sections of the Act: in 50(2) with price discrimination, 61(9) regarding resale price maintenance, 76 regarding consignment selling, 77 regarding exclusive dealing, tied selling and market restriction, and 80 regarding delivered pricing. The term appears to mean something more than a single act something closer to conduct which is repeated over a period of time.[20] The wording in section 79(1)(b) of "a practice of anti-competitive acts" does not make clear whether the same act or set of acts has to occur on a regular basis, or whether each act can occur at irregular intervals, so long as some anticompetitive act with the same outcome occurs on a regular basis.

A whole range of interesting questions arise. For example, is a practice that is part of a multi-year contract a single act, or one repeated over a period of time? In *NutraSweet*, some of the actions, for example a customer being given a rebate for each kilogram of aspartame which it persuaded its co-packers to purchase from NutraSweet, appeared to be once-only contractual occurrences. The Director argued that it was the pattern or scheme of marketing and pricing activities which bound its customers to NutraSweet, inhibits their dealing with competitors, and forms the "practice.".

Next, what constitutes acts which are "anti-competitive"? Section 78 of the Act contains nine non-exhaustive examples of anti-competitive acts (see Appendix A). Each of the examples is of an action that might be permissible by a firm which did not enjoy a dominant position in the market. Each example states an anticompetitive intent or purpose when practiced by a firm with dominant position. The intent or effect of each of the nine is either to squeeze competitors' profit margins, or to raise barriers to new entry or to expansion in the market.

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[19] See *R. v. Canadian General Electric Company Ltd. et al.*, 15 O.R. (2d) (1976), 360.

[20] How long a period constitutes a "practice" is unclear. In the Coutts case, involving a charge of resale price maintenance, the Ontario High Court found that a sale of greeting cards in a particular way over a period of one week constitutes a "practice". The judge stated that "I believe the word is used in the section in the sense that it denotes a distinction from an isolated act or acts" *R. v. William E. Coutts Co. Ltd.*, 1 O.R. 550 (1968), affirmed O.R. 549 (1968).

Is an anti-competitive act simply something that is: (i) not necessarily by itself unlawful or predatory if done by a firm without market dominance, but (ii) is done in a particular case by a firm with market dominance, which either (iii) has the object or purpose of squeezing profit margins, or (iv) raises barriers to new entry or expansion? The four points probably define the constituent parts of an anticompetitive act. The definition is not terribly original; it covers the fact situation in virtually all the monopolization cases under Section 2 of the *Sherman Act* in the U.S., all the nine examples in section 78, and all the anti-competitive acts alleged by the Director in *NutraSweet*.[21]

Exclusionary purpose or reasonably competitive behaviour? Bruce McDonald (1987, p. 67) has pointed out that each of the anticompetitive acts listed in Section 78 contains, either explicitly or implicitly, reference to an exclusionary purpose or object. He raises the issue of whether these refer to a subjective intent, or to a balancing of legitimate business objectives against reasonably anticipated exclusionary effects. Recall that Bill C-91, when originally introduced in 1985, had contained the requirement that the Director must establish that the intent of an anti-competitive practice was to lessen competition. Many who testified before the House of Commons Legislative Committee on C-91 concluded that the requirement of proving intent completely emasculated the provision, and the Committee recommended that the requirement that the Director prove "intent" be dropped.

How will the Tribunal distinguish exclusionary object from reasonably competitive behaviour? At least some of the NutraSweet practices, for example providing rebates to customers for displaying the NutraSweet trade mark or brand name on all their packaging (and thus using only NutraSweet enhanced sweetener in their products) could be argued to be reasonably competitive behaviour.

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[21] These factors are clearly set out in the U.S. context in the famous *RealLemon* case, *In the Matter of Borden, Inc.*, T.T.R. par. 21,490; 92 F.T.C. 669 (1978); *Borden v. F.T.C.*, 1 Trade Cases, par. 64,558 (1982).

Indeed there is some parallel between the activities of *RealLemon*, and those of *NutraSweet*. Borden was held by the Federal Trade Commission decision to be responsible for "erecting barriers to entry into the reconstituted lemon juice market through extensive trademark promotion and advertising which has artificially differentiated Borden's reconstituted lemon juice from comparable products of its competitors". The market dominance of Borden, with 90% of the U.S. market and close to 100% in some sub-markets, was such that at the time of the case the RealLemon name had virtually become the generic name of bottled lemon juice.

Phillip Areeda (1987, p. 962) suggests that conduct by a firm with market power becomes anticompetitive, exclusionary or predatory when it "(1) tends to inhibit the competitive vitality of rivals (or perhaps 'abuses' monopoly power); (2) does not promote the 'legitimate business purposes' or 'competition on the merits' that the antitrust laws are designed to encourage; (3) can be identified in practice by antitrust courts; and (4) can be controlled without unduly chilling legitimate activity."

Eleanor Fox (1986) has argued that there has to be a further requirement for a violation of Section 2 of the *Sherman Act*, that the practice is not aimed at a real consumer need, or that it is not the least restrictive way of filling that need, and thus raises market power unnecessarily.

At the same time of course, it is easily recognizable that another supplier of aspartame would have to set its price at a level which is not only competitive with NutraSweet's price, but which justifies the cost of removing the NutraSweet trademark from the product's packaging, and overcoming any latent consumer recognition factor for the NutraSweet trade name. It is as easy to argue exclusionary object as to argue reasonably competitive behaviour. Is this the kind of practice which offends the statute when practiced by a dominant firm, and may not offend when practiced by one with far less dominance?

The *NutraSweet* case also raises the interesting question of whether a dominant firm can use a "most favoured nation" clause or an "English clause" to guarantee that it will always meet competitive prices. On one hand, (and especially when dealing with what is essentially a commodity chemical), this would seem normal and competitive behaviour. On the other hand, if a dominant firm has never failed to meet a competitive price, that firm's customers may automatically place their entire order with the firm, because they are guaranteed that the price they will pay for the product will always equal the lowest found in the industry.

A final example from *NutraSweet* is the alleged practice by the firm of tailoring individual prices, discounts, rebates, and allowances for each customer, producing net prices which vary across and within industries. This can be argued to be highly competitive behaviour (remembering that there were also "most favoured nation" clauses to prevent anyone from being harmed by the practice). It can also be argued, as the Director has, that the intention is to erect barriers to new entrants gaining a foothold in the market, and to eliminate existing competitors.

Is this a practice analogous for example, to the use of fighting brands "introduced selectively on a temporary basis to discipline or eliminate a competitor" in section 78(d)? Is this a practice that is offensive if carried out by a firm with a high degree of dominance, and less so if the firm has a lower dominance? Does it become offensive for example if lower prices are offered only to counter a competitor that threatens to enter the market, as opposed to a competitor that actually offers a lower price?

Do other practices innocent in themselves, constitute abuse when practiced together?: The question here is whether a number of individual practices, assuming each is below a threshold that might invite intervention by the Director, can when carried out simultaneously constitute an abuse of dominant position. The Director's position on individual practices carried out simultaneously constituting abuse, based on *NutraSweet*, appears to be "yes." Section 107 indicates that evidence might well be relevant in two or more different types of proceedings. While section 107 is probably aimed at allowing, say, a section 75 refusal to supply case to go on simultaneously with a section 77 exclusive dealing case, it likely covers section 79 also.[22]

There are certainly other practices mentioned in the *Competition Act* where some degree of market power may be present. These include the section 50(1)(c) material on predatory pricing, section 75 on refusal to supply, and section 77 on exclusive dealing, tying arrangements, and market restriction.

The Commission of the European Community, the Court of Justice, and a number of jurisdictions in the U.S. have found a very long list of market practices to be anti-competitive when carried out by a firm with market power. These include those mentioned above, plus discriminatory pricing, restrictions on imports or exports, the use of fighting brands, market loading, and even the use of litigation for purposes of harassment.

In *NutraSweet*, the Director submitted that not only a pattern of actions by the company constitute anti-competitive acts within the meaning of section 78 of the Act, but also, "in addition to...or in the alternative," that the same actions constituted exclusive dealing under section 77(1), and tied selling under section 77(1). The Director argued that it was the total scheme of marketing and pricing which bound customers to NutraSweet, and made it uneconomic for them to deal with competitors. To remain competitive, a customer had to take advantage of all the rebates offered by NutraSweet, and to affix the NutraSweet trade mark to its packaging. Although the Director argued that the exclusive dealing and tying arrangements practiced by NutraSweet individually lessened competition, much of his application focused on the sum of the actions as lessening competition substantially.

When can you cut off product or support to downstream dealers?: In a section 75 "refusal to deal" proceeding against Chrysler Canada Limited, the Tribunal ordered Chrysler to resume selling automotive parts to a Montreal-based exporter who had been cut off by Chrysler in 1986. Chrysler argued that the dealer, one Richard Brunet, had agreed not to compete with Chrysler Corporation in selling to franchised dealers overseas, but later told a Peruvian auto dealer he could supply parts more cheaply than could Chrysler's U.S. distributor. Shortly thereafter, Chrysler discontinued selling parts to him.[23]

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[22] Note that section 79(7) of the *Competition Act* provides that no application may be made under Section 79 against a person where proceedings have commenced for conspiracy under Section 45, or against whom an order is sought under section 92 (the merger provisions), "on the basis of the same or substantially the same facts". Sections 45.1 and 98 provide the same protection in conspiracy and merger proceedings. There are no similar protections for section 79, and/or for the sections on price discrimination, predatory pricing, resale price maintenance, refusal to supply, exclusive dealing, tying arrangements, market restriction, or delivered pricing.

It is clear that a refusal to deal by a supplier who has once supplied can be a section 75 offence, and can perhaps be part of a pattern of anti-competitive acts under section 79. The more interesting question is whether a refusal to deal by a supplier who has never supplied can be part of a section 79 offence. Is there a positive obligation on the part of a dominant firm which supplies some customers, to supply all customers on proportionally equal terms? Is there such an obligation on a dominant firm which has traditionally practiced exclusive or selective distribution?

If there is a positive obligation to supply on the part of a firm holding market power, what is the tradeoff between exclusionary purpose and competitive behaviour? Prior to the passage of the *Competition Act* by Parliament, the Restrictive Trade Practices Commission (1986, p. 471) in the Petroleum Inquiry commented on the issue by saying that

> Suppliers who hold high degrees of market power should not be entitled to refuse supply to others except to the extent that they can establish sufficient reason for refusing supply. Market power being a matter of degree, the greater a person's market power is over supply, the less should be the need to prove that the refusal injured someone or that it substantially lessened competition, and the more the focus should be on the adequacy of the supplier's reasons for refusing supply.

In a case analogous to *Chrysler Canada*, the Director in November of 1989 filed a Section 75 refusal to deal application with the Competition Tribunal against Xerox Canada Inc. The Director sought an order that Xerox be forced to supply parts to a small Toronto company, Exdos Corporation, which specializes in selling and servicing used Xerox photocopiers. Many of the facts in *Xerox* suggest the case could have been filed under the abuse of dominant position provisions. The fact that the Director proceeded only under Section 75 suggests that when a single alleged anti-competitive activity by a dominant firm is central to a case, he will argue that narrower provision rather than a broader abuse of dominant position one, before the Tribunal.[24]

3.4 What Is "Substantial," in Lessening Competition in a Market?

A third requirement under section 79 is to show that a practice of anti-competitive acts is likely to "lessen competition substantially." What is substantial? The term occurs in section 50 in relation to predatory pricing, and elsewhere. In the *Chrysler* case, the Competition Tribunal looked at the element in 75(1)(a) of the Act, whether Brunet was "substantially affected" in his business by the refusal of Chrysler to supply him with auto parts. The Tribunal suggested that to understand the effect of the refusal to supply, it would be necessary to answer questions such as: (a) does the product in issue account for a large percentage of the overall business; (b) is the product easily replaced by other products sold in the business; (c) does the sale of the product use up capacity that could be devoted to other activities; and (d) is the product used or sold in conjunction with other products and services so that the effect on the overall results of the business may be much greater than indicated by the volume of the product purchased?[25]

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[23] (1989), 27 C.P.R. (3d) 1. See Blakney (1989). Brunet had since 1976 operated an auto parts export business out of Montreal, selling primarily to South America, but also to a lesser extent to Europe. He sold parts of Chrysler, Ford, and General Motors Canada. when Chrysler cut him off following the approach to a Peruvian dealer, Brunet estimated the change in policy cost him $215,000 in sales and $30,000 in profit each year. The Tribunal ruled that "He merits relief", and ordered Chrysler Canada Ltd. to resume supplying parts to Brunet, even if he sells them overseas in competition with Chrysler.

[24] Supra, note 5.

The Tribunal's general approach in *Chrysler* was to look at the disaggregated effects of a refusal to supply on the affected segment of the business, rather than at the impact on the whole business. For example the fact that Brunet's total sales had increased in spite of the refusal to deal was irrelevant, if sales in the affected sector had fallen.

Unresolved by *Chrysler* are issues including whether "substantial" will in section 79 cases generally refer to quantitative issues of decrease in competition, or to the amount of competition remaining, or will look at a more dynamic analysis of whether competition has been reduced over a long period of time through change in access to some essential element necessary to compete.

Also involved in section 79 is a difficult question relating to "superior performance." Section 79(4) requires a consideration by the Tribunal of whether a practice with the effect of preventing or lessening competition substantially in a market..."is a result of superior competitive performance." Note that it is for the Tribunal to consider whether the practice of anti-competitive acts, and not the lessening of competition, results from superior competitive performance.

This section was thought to refer to experience-curve driven cost advantages which enabled a dominant competitor to price low enough to drive other competitors from the market. But can an anti-competitive practice be the result of superior competitive performance? These anti-competitive acts are only covered under section 79 if carried out by a dominant firm. Does the existence of economic dominance which precedes the anti-competitive act, always create a presumption of superior competitive performance?

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[25] *D.I.R. v. Chrysler Canada Limited (Reasons and Order)*, CT-4-88, October 13, 1989, at 31. The Tribunal goes on to say, at 38-39, "that 'substantial' should be given its ordinary meaning, which means more than something just beyond de minimis. While terms such as 'important' are acceptable synonyms, further clarification can only be provided through evaluations of actual situations."

3.5 Prohibition Orders and Other Remedies

If the Competition Tribunal finds that there has been a substantial lessening of competition, then it may issue a prohibition order. If the Tribunal finds that a prohibition order is not likely to restore competition, then it may make any other additional or alternative order to overcome the effects of the practice. At the extreme, it is specifically empowered to restructure an industry by ordering the divestiture of assets or shares.

The history of negotiated undertakings or consent orders between parties to merger cases and the Director's office suggests that divestiture may well be proposed (see Stanbury, 1991). However a provision in section 79(3) that requires the Tribunal to make its orders "in such terms as will in its opinion interfere with the rights of any person to whom the order is directed or any other person affected by it only to the extent necessary to achieve the purpose of the order" suggests that major structural remedies will be considered by the Tribunal only when prohibition orders directed at behaviour appear to have no chance of success.

The history of negotiated undertakings between Parties to merger cases and the Director's office also suggests that orders requested would be structural rather than behavioural, the latter requiring a long-term monitoring to which the Director's office has shown its reluctant to undertake. The Tribunal also indicated in *Palm Dairies*, the first case to come before it, that it was not prepared to make an order which required extensive monitoring.[26] In the *Gemini* case, the Director accepted some monitoring, but the monitoring was to be done by competitors, not by the Director's office.[27]

It is interesting to look at the remedies asked for in the *NutraSweet* case. The Director's submission was that, because of NutraSweet's practices of anti-competitive acts preventing or lessening competition substantially in the supply of aspartame, an order under section 79(1) of the Act alone would not be likely to restore competition. Specifically, the Director has applied to the Tribunal in the NutraSweet case for an order under section 79(1) to prohibit NutraSweet:

- from negotiating or entering into contracts with multinational customers which govern the supply of aspertame to the Canadian affiliates of such customers;
- from requiring customers to purchase from them their entire supply of aspartame;
- from pricing sales of aspartame to Canadian customers below its acquisition costs; and

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[26] *DIR v. Palm Dairies et al.*, CT-1-86 (September, 1986); (1986) 12 C.P.R. (3d) 540.

[27] *DIR v. Air Canada et al.*, CT-1-88/1; Competition Tribunal, "Reasons for Consent Order Dated July 7, 1989."

- from selectively reducing Canadian prices in such a way as to inhibit competition.

Note that the first two parts of the order requested, asked a Canadian tribunal to order a U.S.-based multinational to stop doing something in the U.S., because the effects of their actions are felt in Canada. The third and fourth parts ask for an order which will result in higher prices in Canada, rather than lower.

In addition, the Director applied under Section 77(2), for a declaration that a number of clauses contained in contracts between NutraSweet and its customers, are null and void and may not be judicially enforced. The clauses are those involving exclusive dealing, exclusive use, volume incentives, the "English clauses," extended release, most favoured nation, trade mark display, promotional advertising, and clauses which prohibit or penalize exportation or processed product into the United States. The Director has also requested an order that most of these conditions not be placed in future contracts.

The Director sought under section 77(2) a declaration that any contracts entered into by NutraSweet or its affiliates pursuant to world-wide contracts or clauses involving exclusive supply clauses, exclusive use clauses, volume discounts, and the like, are of no force and effect insofar as they affect the supply of aspartame in Canada.

The Director also sought an order directing NutraSweet not to require in a supply contract an annual volume commitment greater than 50% of the customer's total annual anticipated volume requirements.

Perhaps most interesting, the Director pursuant to section 77(2) sought an order requiring NutraSweet to reimburse a customer for the cost of removing the NutraSweet trade mark from its advertising plates or similar properties, when the customer decides to purchase aspartame elsewhere.

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Appendix A

SECTIONS 78 AND 79 OF THE COMPETITION ACT

The criminal monopoly provisions under section 33 of the old *Combines Investigation Act* were repealed in June, 1986, and replaced by sections 50 and 51 of the *Competition Act*, which introduce the concept of "abuse of dominant position," a practice reviewable within the civil jurisdiction of the Competition Tribunal. The Revised Statutes of Canada came into force on December 12, 1988. As a result, the section numbers of the *Competition Act* changed, with sections 50 and 51 becoming sections 78 and 79. The sections read as follows.

> **78.** For the purposes of section 79, "anti-competitive act," without restricting the generality of the term, includes any of the following acts:
>
> (a) squeezing, by a vertically integrated supplier, of the margin available to an unintegrated customer who competes with the supplier, for the purpose of impeding or preventing the customer's entry into, or expansion in, a market;
>
> (b) acquisition by a supplier of a customer who would otherwise be available to a competitor of the supplier, or acquisition by a customer of a supplier who would otherwise be available to a competitor of the customer, for the purpose of impeding or preventing the competitor's entry into, or eliminating him from, a market;
>
> (c) freight equalization on the plant of a competitor for the purpose of impeding or preventing his entry into, or eliminating him from, a market;
>
> (d) use of fighting brands introduced selectively on a temporary basis to discipline or eliminate a competitor;
>
> (e) pre-emption of scarce facilities or resources required by a competitor for the operation of a business, with the object of withholding the facilities or resources from a market;
>
> (f) buying up of products to prevent the erosion of existing price levels;
>
> (g) adoption of product specifications that are incompatible with products produced by any other person and are designed to prevent his entry into, or to eliminate him from, a market;
>
> (h) requiring or inducing a supplier to sell only or primarily to certain customers, or to refrain from selling to a competitor, with the object of preventing a competitor's entry into, or expansion in, a market; and
>
> (i) selling articles at a price lower than the acquisition cost for the purpose of disciplining or eliminating a competitor.
>
> **79**(1) where, on application by the Director, the Tribunal finds that:
>
> (a) one or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business,
>
> (b) that person or those persons have engaged in or are engaging in a practice of anti-competitive acts, and

(c) the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market, the Tribunal may make an order prohibiting all or any of those persons from engaging in that practice.

(2) where, on an application under subsection (1), the Tribunal finds that a practice of anti-competitive acts has had or is having the effect of preventing or lessening competition substantially in a market and that an order under subsection (1) is not likely to restore competition in that market, the Tribunal may, in addition to or in lieu of making an order under subsection (1), make an order directing any or all the persons against whom an order is sought to take such actions, including the divestiture of assets or shares, as are reasonable and as are necessary to overcome the effects of the practice in that market.

(3) In making an order under subsection (2), the Tribunal shall make the order in such terms as will in its opinion interfere with the rights of any person to whom the order is directed or any other person affected by it only to the extent necessary to achieve the purpose of the order.

(4) In determining, for the purposes of subsection (1), whether a practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market, the Tribunal shall consider whether the practice is a result of superior competitive performance..

(5) For the purpose of this section, an act engaged in pursuant only to the exercise of any right or enjoyment of any interest derived under the *Copyright Act*, *Industrial Design Act*, *Patent Act*, *Trade Marks Act*, or any other Act of Parliament pertaining to intellectual or industrial property is not an anti-competitive act.

(6) No application may be made under this section in respect of a practice of anti-competitive acts more than three years after the practice has ceased.

(7) No application may be made under this section against a person
(a) against whom proceedings have been commenced under Section 45, or
(b) against whom an order is sought under section 92

on the basis of the same or substantially the same facts as would be alleged in the proceedings under section 45 or 92, as the case may be.

Chapter 14

ABUSE OF DOMINANT POSITION: FROM BORK TO BAIN AND BACK AGAIN (BUT THIS TIME WITH EXTRATERRITORIALITY)

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1.0 INTRODUCTION

On the 100th anniversary of competition legislation in Canada I thought it might be advisable to adopt a broader, more historical slant to the matter of abuse of dominant position. I did so in part because some excellent publications already exist which analyze very well the elements of the abuse of dominant position provisions in the 1986 *Competition Act*. See, in particular, Bruce McDonald's magnificent analysis[1] and the response of Messrs. Anderson and Khosla,[2] whose scholarship in this and other areas of competition law I admire. In addition, there is a theoretical critique of abuse of dominant position by Messrs. Martin and Martin.[3]

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[*]. Also Director, Canada-U.S. Law Institute. The able assistance in the final preparation of this paper of Duff Heath, a 1990 graduate of the Faculty of Law, is gratefully acknowledged.

[1] Bruce C. McDonald, "Abuse of Dominant Position," *Canadian Competition Policy Record*, Vol. 8, No. 1, March, 1987, pp. 59-75. Mr. McDonald breaks the provisions down into four basic issues that arise in the analysis of abuse cases: (1) Does dominance exist? (2) Was there abuse? (3) Has competition been substantially lessened as a result? (4) If so, can a remedy be designed that is not worse than the mischief?

[2] R.D. Anderson and S.D. Khosla, "Reflections on McDonald on Abuse of Dominant Position," *Canadian Competition Policy Record*, Vol. 8, No. 3, September, 1987, pp. 51-60. This article adds some commentary to Mr. McDonald's work by delving into specific parts of the legislation such as, *inter alia*, class or species of business, and the test of lessening competition substantially. It also covers some aspects not addressed by McDonald, for example, intellectual property rights and superior competitive performance.

I now turn to my main topic, which is a modest attempt to assess our abuse of dominant position provisions in the context of the following thesis -- a recognition of the political sacrifice which was made when our new *Competition Act*[4] was enacted, and consideration of whether the abuse of dominant position provisions serve to bring Canada the benefits for which that sacrifice was made. I don't think that they do.

2.0 THE POLITICAL SACRIFICE

2.1 In the Beginning: The Reaction Against Great Aggregation of Wealth and Power

One hundred years ago, the prevailing mood in both Canada and the United States[5] could be summarized as follows: "An economic world run by a handful of giant organizations in which one man tells a million others what to do has never been our idea of the good society, economically or otherwise. ..."[6] We experienced a reaction to great aggregations of wealth and power. In the period 1865-1890, the industrial revolution and the construction of railroads had made possible the doing of business on a large scale. A widely fluctuating dollar was eliminating many small businesses.[7] Cut-throat competition and predatory practices aimed at destroying competitors were rampant.[8] Many businessmen became attracted to the idea of combining to gain relief from these pressures and to achieve supposedly desirable economies of scale.[9] The result was that there emerged several famous trusts,[10] such as the Sugar Trust and the Standard Oil Trust, which essentially wielded monopoly power in their respective industries. Under the trust device, each participating corporation gave up control of its business and properties to certain designated trustees. In return they received trust certificates representing the value of the assets transferred to the trust. From there on the trustees assumed total control of the operation of the business.

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[3] Roger L. Martin and Brad Martin, "Abuse of Dominance or Abuse of Reason?," *Canadian Competition Policy Record*, Vol. 8, No. 3, at 61-67. This article attempts a "Borkian" analysis of the new abuse of dominance provisions, It concludes that the provisions exhibit "muddled thinking" and that they will give rise to nothing but confusion and controversy. The authors posit that the legislation should be replaced by an exclusionary practices section based upon "Borkian" reasoning.

[4] *Competition Act*, R.S.C. 1985, c. C-34. For a review of sections 78 and 79 see the paper by Donald Thompson in Part 4 of this volume.

[5] *Sherman Act*, 15 U.S.C.A. S. 1-7. S. 2. Every person who shall monopolize, or attempt to monopolize any part of trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by a fine not exceeding one million dollars, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

[6] Editors', "Foreword: Is Structuralism Still Alive and Well in Antitrust?, *Antitrust Law & Economics Review*, Vol. 15, No. 1, 1983, p. 8.

[7] Hans B. Thorelli, *The Federal Antitrust Policy* (Baltimore: The Johns Hopkins Press, 1955), pp. 54-64. It should be noted that much of the industrial growth early in this period was financed by ploughing retained earnings back into the businesses-- not through amalgamation. Many small businesses were also being eliminated by their inability to keep up with the rapidly changing technology.

While this was happening, there were mixed feelings among business people, legislators and the public. In the more heavily industrialized areas, there was wide-spread feeling that the emergence of trusts was an inevitable result of a form of neo- Darwinism, i.e., survival of the fittest, and that in any event "big was beautiful" in the sense that "any increase in the size of an enterprise automatically meant an increase in efficiency."[11]

In the decade of the 1880's, however, a new school of economists began to question the value of neo-Darwinism and *laissez-faire* economics.[12] Newspapers and magazines began to attack the trusts. Demands for Parliament to legislate an effective remedy arose.[13] In the United States, the established Republican and Democratic parties were threatened with loss of representation to a third party in the West and South if they refused to act.[14]

The result was that by 1888, the House of Commons appointed a committee to inquire into combinations and trusts in Canada and their effect on the Canadian economy.[15] This led to the Act of 1889, which in 1892 was codified as Section 498 of the Criminal Code. As to the United States, on July 10, 1888, Senator Sherman of Ohio introduced a resolution, which after considerable debate and amendment was signed into law as the *Sherman Anti-Trust Act* on July 2, 1890.

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[8] Thorelli, *op cit.* at 67-68.

[9] Thorelli, *op. cit.* at 68-71. These businessmen rationalized the concentration of the market, and thus their own individual size, on the basis that there was "excessive" competition which reflected a current state of overexpansion. Combination, then, lent itself easily as the remedy for the problem. Furthermore, since consumers were ostensibly benefited by lower prices, the climate of concentration was considered an immediate improvement.

[10] Thorelli, *op. cit.* at 36-37 and 76. The "trust" was essentially a consolidated holding company. One of the primary reasons for its establishment was the desire to avoid the weaknesses experienced with simple agreements and pooling arrangements. With unified control it was believed that the risks of obstruction on the part of any participant could be eliminated. The Standard Oil Trust served as the pattern for most of the subsequent ones.

[11] Thorelli, *op. cit.* at 71.

[12] Thorelli, *op. cit.* at 119. For example, the American Economic Association considered that the state had the responsibility to foster economic conditions that would guard against the negative effects of "blind pecuniary egotism."

[13] Thorelli, *op. cit.* at 143. This can be seen in the growth of antimonopolistic political parties, especially in agrarian communities.

[14] Thorelli, *op. cit.* at 151. "The importance of monopolies in the public mind made it too obvious a political asset for wise politicians to ignore."

It would be stretching reality considerably to suggest that there was a coherent economic theory underlying either piece of legislation. The most that can be said is that they were a reaction and, perhaps, a rejection. They were a reaction to the power of the combinations and trusts, and a rejection of the "big is beautiful" neo-Darwinism which previously held sway.

2.2 The Alternative: Dispersal of Economic and Political Power

It was not long though, at least in the scale of human history, for an alternative economic rationale to appear. This was "structuralism." It was best typified in the writings of Dr. Joe S. Bain, which appeared in the 1950's.[16] The idea was to use competition policy to ensure that the firms in an industry did not become any larger than their minimum-efficient scale (MES). You did this by determining how small a firm could be in a particular industry and still produce its products at the lowest possible per unit cost. Then, competition policy would be used to ensure that no firm became any larger than that.[17]

This was seen as "enormously appealing on a host of grounds, economic, political, and philosophical. ... With such a large number of relatively small firms competing in each of our individual industries, consumers would be assured of all of the fruits of intense competition, including the lowest prices and the best products; with no monopoly profits being earned anywhere, there would by definition be no appreciable amount of economic, social or political power in the system; with no large business organizations there would be no need for large countervailing labour and governmental organizations; and with no entrenched blocs of power to stand in their way, new enterprises could be created and made to prosper with relative ease, thus assuring a broad dispersion of wealth and opportunity."[18] I think we can all agree that political power follows economic power and that in a nation in which economic power is concentrated in the hands of a few, there is an enormous dilution of voter strength.[19]

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[15] Mr. N. Clarke Wallace, a Conservative Member of Parliament, intervened in a Toronto mayoralty election, accusing one of the candidates of leading a coal-ring which engaged in price-fixing. From there he developed a reputation as being an enemy of combines and was appointed chairman of a House of Commons Select Committee to investigate combines in Canada. See Michael Bliss, "Another Antitrust Tradition: Canadian Anti-Combines Policy, 1889-1910," *Business History Review*, Vol. 47, No. 2, 1973, pp. 177-88.

[16] See R. T. Masson & David Qualls, Eds., *Essays on Industrial Organization in Honor of Joe S. Bain* (Cambridge: Ballinger Publishing Co., 1976), pp. 2-3. Dr. Bain's main effort was to demonstrate that the primary forms of firm behaviour are shaped by the structure of the particular industry. Hence, if the structure could be changed, so would the conduct of the participants. Two of Bain's most important works were *Industrial Organization* 2nd ed. (New York: Wiley, 1968) and *Barriers to New Competition* (Cambridge, Mass.: Harvard University Press, 1956).

[17] This line of thinking manifested itself in the United States Supreme Court decision in the *Alcoa* case (*United States v. Aluminum Co. of America*, 148 F., 2d 416 (2nd Cir. 1945)). There it was held, *inter alia*, that Alcoa's structural dominance of the market prohibited it from acting like an ordinary competitor.

Early on in this century, structuralism probably seemed like a good economic policy to adopt in Canada. At that time, Canada expected its population to grow by leaps and bounds.[20] With the railroad binding the country together from East to West and high tariff barriers protecting us from outsiders, it probably seemed realistic to expect that within the borders of Canada there would arise a number of efficient firms in each industry. Structuralism would ensure that they remained at their minimum-efficient scale (MES), thereby guaranteeing Canadians the economic, political and social benefits to be gained from that approach. The same may be said, perhaps more emphatically, for the United States.

But I do not pretend that the world of Bain ever really was implemented in the United States, and certainly not in Canada. While Bain's theories had a tremendous impact upon competition policy makers in both countries, the courts were for the most part uncooperative.[21] By the 1970's it seemed obvious to almost everyone that despite the attractiveness of structuralism on economic, political and philosophical grounds, there had been virtual failure in attempts to implement it. It didn't stop the trend, toward concentration of many industries into oligopolies. In the United States, the participants in many oligopolies became far larger than Bain's minimum efficient size.

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[18] "Is Structuralism Still Alive," *Supra*, note 6.

[19] In a representative democracy, legislation is said to reflect the will of the people because it is shaped by those who are elected to represent the people and who will be called to account for their actions on the next election day. In a country where only a few control hundreds of thousands of jobs, however, this power is diluted. The government is subjected to coercive economic power in the hands of the few and may as a result be induced to enact legislation reflecting their will and not necessarily that of the people. This equation cannot be changed on election day. The next government will be subjected to the same degree of coercion as the last.

[20] Johannes Overbeek, *Population & Canadian Society* (Toronto: Butterworths, 1980), pp. 10-13. The period 1901-1911 experienced high population growth in Canada due especially to the opening up of the Canadian "West" which brought in waves of settlers, and also the completion of the railway linking the various parts of the country together. The relatively high degree of immigration was also due to unfavourable conditions overseas.

Given those factors, combined with the post-WWI situation, the expectation that the population would continue to grow was quite reasonable. However, with the onslaught of increased migration to the U.S. and the depression, such was not the case. In short, Canada has experienced small bursts of immigration followed by longer periods of gradual emigration to the south.

[21] In Canada, the criminal law power, under which federal anticombines legislation was enacted, was regarded as being in conflict with the provincial power over property and hence incapable of supporting an order effecting the restructuring of an industry. In the United States, the merger trend continued fairly unimpeded by antitrust. Arthur D. Austin criticized the entire

It might be argued that anyway, structuralism was out of place in Canada's competition policy. Our anticipated large population never materialized. We became a nation with a small consumer base. Up until recent times, we had a branch plant economy. It would be hard to resist a suggestion that Canada's problem was not how to prevent firms from growing beyond their minimum efficient size, but how to get them there -- how to get them there so that they could compete in an efficient manner.

2.3 Rejection of Political and Social Considerations: Consumer Welfare Via Economic Efficiency Becomes "King"

Enter Posner[22] and Bork and their many disciples. Or should I say, re-enter, because in a real sense our competition policy has gone from Bork to Bain and back again. For, you see, the economic theories of Bork have been seen to bear much in common with the neo-Darwinism, etc., which existed in the decades leading up to the enactment of our first competition law.[23] For instance, in a recent book by two well-known American economists, Walter Adams and James W. Brock, Bork is described as a "neo-Darwinist," who contends that industrial "giantism" is both inevitable and desirable, and that to interfere with firm or industry size would undermine economic efficiency.[24]

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process of antitrust litigation in his book *Antitrust: Law, Economics, Policy* (New York: Matthew Bender, 1976), s. 3.8.: "Almost every proceeding is a "big case," dragging on for years (average length of a litigated antitrust case 5 1/2 years). Each trial produces a lengthy record, along with stacks of voluminous exhibits and documents. Vague and obfuscatory language in the decisions provides counsel with the opportunity to cloud the issues resulting in further delay. Lack of particularity in framing the issues leads to unlimited discover, reducing the courts to investigatory bodies."

[22] See, for example, his *Antitrust Law: An Economic Perspective* (Chicago: University of Chicago Press, 1976).

[23] For a good indication of Professor Bork's ideology, see his book, *The Antitrust Paradox*, 1st ed. (New York: Basic Books, 1978), p. 118. "The firm that adapts to the environment better than its rivals tends to expand. The less successful firm tends to contract -- perhaps, eventually, to become extinct. Since coping successfully with the economic environment also forwards consumer welfare, economic [sic] natural selection has normative implications that physical natural selection does not have. ..."

[24] Walter Adams & James W. Brock, *The Bigness Complex* (New York: Pantheon Books, 1986), p. 28.

The neo-Darwinists, Adams and Brock say, "would put their faith in the select few anointed by an untrammelled *laissez-faire* market place."[25]

And do you recall that quote with which I opened these remarks? I will repeat it: "An economic world run by a handful of giant organizations in which one man tells a million others what to do has never been our idea of the good society, economically or otherwise."[26] That was not written in the 1880's. It was written in the 1980's by the editors of the *Anti-Trust Law & Economics Review*. It was in the concluding paragraph of a plea for support in rejecting the neo-Darwinism of Bork and his colleagues.

I suppose that this is a good time to throw around a few old adages like "everything old is new again" or "wait long enough and history will repeat itself." In this case, I suppose the "long enough" works out to about 100 years.

So, in the beginning our competition laws were enacted in reaction to, and rejection of, the economic and political power created by the neo-Darwinian or "Borkian" economics which are so prevalent today. In pointing out this irony, I am not suggesting that Canada reject once again the "giantism" or neo-Darwinism of Borkian economics. I can see that at some point in the future, the United States may return to a national policy of structuralism. With its large domestic market, that might be possible. But most would agree that with our small consumer base we cannot afford that luxury. There is a good argument that unless our nation is to become technologically backward and impoverished, we must allow our firms to become big enough to "go global," even if that means concentrating economic -- and therefore, political -- power in this country into the hands of a few.

2.4 The Political Sacrifice Inherent in the 1986 Competition Act

You need only look at the 1986 *Competition Act* and the *Free Trade Agreement*[27] to see that Canada has already made this "bittersweet" decision. It has made the uneasy trade-off between economic efficiency, or in Borkian terms, consumer welfare, and voter strength. In the pursuit of efficiency, Canadian industry has been given the "go-ahead" to combine or merge even to the point of dominance or monopoly. So long as there are efficiency gains to be had, there will be little to stop them.[28] There will be an ever-increasing concentration of economic, and therefore political, power into the hands of a few. The influence of voters upon governmental decision-making will become more and more diluted.

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[25] *Ibid.* at 371.

[26] *Supra*, note 6.

[27] For example, from the U.S. perspective, investment rules in Canada have been relaxed under the *Free Trade Agreement*. The higher thresholds for direct investment in many industries will exempt all but very substantial transactions. The review of indirect transactions, which has an extraterritorial effect that is objectionable to the Americans, will disappear in three years (after the Agreement came into effect). See *The Canada-U.S. Free Trade Agreement*, Annex 1607.3.

Some might say that while voter welfare has thus been compromised, consumer welfare has been enhanced. Hand-in-hand with concentration, it might be said, has come a shift from a national to a global focus. These new Canadian giants will be urged, even required, to compete in North American and, ultimately, global markets.[29] Tariff and non-tariff barriers will be lowered or eliminated to "invite in" foreign competition. In short, national competition will be replaced by the global competition of efficient industries, thereby ensuring Canadian consumers of highest possible quality at lowest possible price.

3.0 THE BENEFITS: DID WE GET THEM?

I doubt, however, whether those benefits will be forthcoming. Given the shift in economic outlook from national to global competition, I should have thought that the 1986 amendments which brought into being the *Competition Act* would likewise have reflected a global focus. A global focus particularly in the abuse of dominant position provisions. For I agree with Bruce MacDonald's analysis that the abuse of dominant position provisions must have been intended to govern what happens to dominant firms once they have been allowed to grow to that size through merger or otherwise. That seems to me to require two things:

(1) A Defence to Ensure that Canadian Consumers Receive the Benefit of Economic Efficiency Induced by Global Competition: Something to keep the new Canadian giants honest at home, to prevent them from taking steps to preclude foreign competitors from entering and competing in their home territory, Canada.

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[28] See the *Competition Act*, s. 97: if the efficiency gains are "greater than, and will offset, the effects of any prevention or lessening of competition, "then the Tribunal may not make any order" in restraint of the merger. See also s. 80(4): when considering abuse of dominant position, the Tribunal must be sensitive to what may be consequences of superior competitive performance.

[29] The former Director of the Bureau of Competition Policy recognizes the shift towards "globalization". He recently said: "Canada is one of the first industrialized nations to have a competition law that recognizes the importance of a firm's need to restructure to achieve efficiency gains in bringing about increased export or import substitutions. These provisions and others in the legislation reflect the role that international economic factors may play in the assessment of merger cases. ..." (Calvin S. Goldman, "Merger Review Under Canadian Competition Law: Quest For Balance," *Canadian Competition Policy Record*, Vol. 10, No. 3, September 1989, p. 44 at 47).

(2) An Offence to Protect Canadian Investment and Aspirations: Something to protect the new Canadian giants, our new global gladiators, from the impact of anticompetitive tactics of others in the world market once they step outside our borders.

There must be a "Defence" and an "Offence." You can't have one without the other. If you forget the "Offence" our new Canadian giants are liable to be wrecked upon the shoals of global competition.

Let me give you an example of what I mean: I'll talk about widgets but in the back of your minds you might substitute our brewing industry. Suppose that all of the widget manufacturers in Canada merged into one Canadian giant called Company A. Tariff and other trade barriers are reduced to "zero." Widgets are such that they may be efficiently manufactured in one location and shipped all over the industrialized world. Company A's plant is world-class. It is located in Toronto. Although A has 80% of sales in the geographic area called Canada, it has only 5% of this so-called global market. Company B, an American corporation, has 60% of the global market. Becoming irritated by aggressive moves made by A in the United Kingdom, Company B induces a Dutch supplier of critical widget ingredients to refuse to supply A. An alternative source of supply will not be available to A for several months. Company A will be crippled and perhaps even bankrupted if it does not get assistance from the Canadian government.

Now this inducement of refusal to supply a critical ingredient is an act which might fall within paragraph (e) of the list of anti-competitive acts in s.78, i.e., preemption of scarce resources required by a competitor for the operation of a business, or paragraph (h) of the list, requiring or inducing a supplier to refrain from selling to a competitor, with the object of preventing a competitor's entry into, or expansion in, a market. But even so, the Director of Investigation and Research would be powerless to help Company A.

That is because for some unexplained reason, our abuse of dominant position provisions forgot all about offence. Their only focus is upon defence. The defence of economic efficiency, and ergo, consumer welfare, in Canada. They only attack persons who are dominant in Canada, who substantially or completely control throughout Canada or any area thereof, a class or species of business.[30] The provisions completely ignore the fact that a foreign-based

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[30] Even this defensive goal is not likely to be achieved. The problem is that the abuse of dominant position provisions contemplate as many as three (3) different markets: (1) The "class or species of business in Canada" dominated by the Canadian giant; (2) The "market" in which the anticompetitive act(s) took place; and (3) The "market" where competition is or is likely to be substantially lessened.

The term "class or species of business in Canada is quite narrow. It could not have been intended to be defined by economically rational factors. Economically-defined markets may be international in scope. But "class or species of business" is expressly limited to Canada. Moreover, in *Eddy Match Co. Ltd. et al. v. The Queen* (1953), 20 C.P.R. 107 (Que. C.A.), Casey, J.A. defined "class or species of business" in a narrow manner which did not take into account any rational economic factors such as cross-elasticity of demand between wooden matches and competitor can be dominant in the global market, yet have only a small segment of the market in Canada. And that this foreign based competitor can destroy the new Canadian entrant.

It is no answer to say that Canada could raise its tariff barriers. That would give Company A a nice, secure monopoly and sacrifice the defence of consumer welfare in Canada.

It is no answer to say that Company A could sue in the United States under the U.S. antitrust laws. American courts only assert extraterritorial jurisdiction under the U.S. antitrust laws where there has been a significant adverse effect upon U.S. foreign commerce.[31] In any event, how sympathetic to the plight of a Canadian Corporation might a foreign court be. The only jurisdiction which is suffering harmful effects is Canada.

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e.g., paper matches. Accordingly, it would seem that Parliament intends that any company having a relatively large share of sales of a particular line of products in Canada be regarded as controlling that "class or species of business" for purposes of defining it as "dominant".

The use of the term "market," however, carries an entirely different connotation: that the "market" must be economically defined. This means that a larger geographic area, e.g., Canada and the United States, might have to be used for purposes of determining whether the anticompetitive acts of the "dominant" firm created a substantial lessening of competition.

Now consider the impact of this analysis upon the example given in this paper, only with one change: Company A attempts to use self-help to replace the tariff barriers which used to protect its position in Canada. It signs, e.g., long-term requirements contracts with its Canadian customers, thus precluding Company B, the U. S. competitor, from bidding for these customers for a period of years. At the same time, Company A enters into active competition with Company B in the United States.

What is the geographic "market" for the purpose of deciding whether Company A's anticompetitive act substantially lessened competition: Canada alone or Canada plus the United States? Chances are that it is Canada plus the United States. There are no externally-imposed entry barriers like high tariff walls to geographically divide the countries. Transportation costs, etc., are such that widgets can be efficiently shipped all over North America. There are no labelling or safety requirements, etc., that would lead to industry recognition of Canada as a separate geographic market. The only thing that is keeping Company B out of Canada is the unilateral anticompetitive act of Company A. But the effect of a unilateral anticompetitive act by one competitor does not seem to be capable, in economic terms, of defining a geographic market. Rather, it only serves to define the degree to which the anticompetitive act lessened competition in a larger geographic market, i.e., Canada plus the United States. In this combined geographic market, the degree of lessening would only be about 5% -- hardly enough, it would seem, to satisfy the requirement for a "substantial lessening" of competition. So it is likely that the actions of Company A would not constitute an abuse of dominant position within the meaning of our provisions. In other words, the provisions would fail to defend the interests of Canadian consumers in reaping the benefits of global competition. Company A would remain substantially alone as the sole supplier of widgets to Canadians.

[31] See Donald I. Baker, "Extraterritorial Application of United States Trade Law: Problems for Canada -- Recommendations for the United States and Canada," *Canada-U.S. Law Journal*, Vol. 2, Summer, 1979, p.. 152 at 156: "We have suggested that the United States prosecutors should assert jurisdiction only: (1) where a restraint has a substantial impact on United States import trade; or (2) where a substantial and direct private restraint exists on the export trade opportunities for firms operating in the United States. ... [This] is the view stated in the Justice Department's 1977 *Antitrust Guide for International Operations*. ..."

4.0 A MODEST PROPOSAL FOR A REMEDY

It seems to me that this failure to provide offensive protection for Canadian companies competing in global markets is a significant omission in coverage which must be addressed by Canada. It might be addressed in two ways:

(1) Adopting the notion of extraterritoriality. This would involve placing under the civil jurisdiction of the courts an abuse of dominant position provision which does not restrict the definition of "dominance" to Canada and instructs the civil courts to assert extraterritorial jurisdiction, both personal and subject matter, in cases in which the foreign commerce of Canada is adversely affected. To ensure that foreign corporations will come in to defend, it might also be provided that any judgment may be satisfied by execution against the property in Canada of the foreign corporation, its wholly-owned affiliates or parent. Whether the action would be at the instance of the Canadian corporation or Director of Investigation and Research would be a matter of choice on the part of Parliament.[32] or

(2) Establishing with the United States and/or other significant trading partners an international tribunal to adjudicate complaints of anticompetitive acts in the international marketplace.

I prefer the first solution, extraterritoriality, at least for the short term. Unilateral action has the advantage of speed. Negotiating an international tribunal into existence could be a cumbersome and lengthy process. (I do not know whether such a tribunal is contemplated as part of the negotiation of the Free Trade Agreement. I will mention one advantage of a Canada-U.S. Competition Tribunal: because of the large size of the markets under its jurisdiction, it could adopt a "structuralist" approach to competition policy, thereby protecting voter welfare as well as consumer welfare on an international scale. But then, this could have implications for political integration -- a very sensitive topic in Canada at the moment.)

So let us go with the first, unilateral assertion through our courts of extraterritorial jurisdiction over abuses of dominant position which adversely affect Canadian commerce. Now, I realize that there has been a long-standing opposition to extraterritoriality in Canada. This, I believe, has two origins: First, Competition law in Canada has long been enforced through Parliament's criminal law power, and criminal law is intensely local in nature. It seems axiomatic in Canada that you cannot make a crime out of something that happened outside your borders, nor can you extradite a foreign corporation to stand trial for a crime that happened inside your borders.[33] Because of this, our anticombines enforcers have gotten used to looking inward and have not fully grasped the expansion of jurisdiction inherent in the new civil justifications for federal anticombines laws.

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[32] In order to protect the consumer welfare of Canadians by ensuring that they get the benefit of global competition, the existing provisions could be retained, but with an amendment indicating that the test to be applied by the Tribunal is not "substantial lessening of competition in the market," but denial to Canadians of the benefits of global competition.

Secondly, there has been in Canada a nationalistic reaction to attempts by the United States extraterritorially to apply its own laws. But it seems to me that the United States might have adopted extraterritoriality in response to precisely the same pressures that Canada now faces. Much of American industry has competed on a global basis for the better part of this century.

The point is, if you adopt a global approach to economic policy, you must do likewise with the legislation intended to implement and enforce that policy. It must protect consumer welfare at home and Canadian commerce abroad. In a world of low or no tariff barriers and great aggregations of economic power it is self-defeating to have, as we appear to have now, one without the other.

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[33] For example, see *R. v. Campbell*, [1964] 2 O.R. 487, (C.A.), where the hapless Canadian agent of Bard-Parker was prosecuted and found guilty of resale price maintenance, even though the entire scheme was initiated and implemented by an American corporation, Bard-Parker.

Chapter 15

THE LAW OF PRICE MAINTENANCE IN CANADA: REVIEW AND ASSESSMENT

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1.0 INTRODUCTION

The law of price maintenance and refusal to supply has been relatively uncontroversial unlike other provisions in the *Competition Act*. The policy rationale underlying these offences is, however, the subject of intense debate among academics and policy-makers.[2]

The original form of these offences, enacted in 1951,[3] focussed on restraints placed by a supplier on the resale prices, mark-ups and discounts charged, applied or given by its dealers on articles supplied. The price maintenance provision prohibited both resale price maintenance which was required or induced and attempts to require or induce resale price maintenance in the form of an agreement, threat, promise or any other means.

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[1] The author specializes in economic regulation with an emphasis on competition law and international trade law. The author wishes to acknowledge the invaluable research assistance of Tamara Hunter. Her paper, "History of Price Maintenance Legislation in Canada" is included in R.S. Khemani and W.T. Stanbury (eds.) *Historical Perspectives on Canadian Competition Policy* (Halifax: The Institute for Research on Public Policy).

[2] See, for example, Frank G. Mathewson and Ralph A. Winter, *Competition Policy and Vertical Exchange* (Toronto: University of Toronto Press, 1985); Bruce Dunlop, David McQueen and Michael Trebilcock, *Canadian Competition Policy: A Legal and Economic Analysis* (Toronto: Canada Law Book Inc., 1987), Ch. 9; and J.W. Morrow, "Resale Price Maintenance Under Review," *Canadian Competition Policy Record*, Vol. 11(1), 1990, pp. 39-45 and the response by Mathewson and Winter, pp. 45-49.

[3] *An Act to Amend the Combines Investigation Act*, S.C. 1951 [2nd sess.], c. 30, s. 1 amending *Combines Investigation Act*, R.S.C. 1927, c. 26. See Hunter, *supra*, note 1.

In 1960 loss-leadering, bait and switch selling, misleading advertising and not providing the expected level of servicing were introduced as statutory defences to the offence of refusal to sell or supply or counselling the refusal to sell or supply.[4] Both offences were cast in a new form in 1976 as a part of a major revision to the *Combines Investigation Act*.[5]

The scope of the previous offence of resale price maintenance was enlarged. It was no longer limited to resale price maintenance. It became applicable to price maintenance regardless of whether the person attempting to maintain prices and the person who was the target of the attempt were both part of the same distribution process. The essence of the offence became an attempt to influence prices upwards or to discourage the reduction of prices by the means of an agreement, threat, promise or any like means. The limits on the use of suggested resale prices and published resale prices were purportedly demarcated.

The offence of refusal to supply was enlarged to include discrimination in addition to refusal to supply. The essence of the offence became a refusal to supply or otherwise discriminate because of the low pricing policy of the person against whom the refusal or discrimination is directed. The statutory defences were retained in virtually unamended form.

The 1976 amendments also introduced a new offence prohibiting a person from inducing a supplier to refuse to supply another person because of the low pricing policy of that other person.

The changes introduced by the 1976 amendments were virtually unaffected by the major revisions in 1986.[6]

The text of the original enactment and the various amendments thereto are set out in Appendix A.

The number of cases is reported in Table 1.

2.0 PRICE MAINTENANCE

Price maintenance under S.61 of the *Competition Act* is concerned with

(a) an agreement, threat, promise or any like means;
(b) by any person engaged in business to attempt;
(c) to influence upward or to discourage the reduction of the price;
(d) at which any other person engaged in business supplies, offers to supply or advertises a product within Canada.

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[4] *An Act to Amend the Combines Investigation Act and the Criminal Code*, S.C. 1960, c. 45, s. 14.

[5] *An Act to Amend the Combines Investigation Act*, S.C. 1974-75-76, c. 76, s. 18(1).

[6] *An Act to Establish the Competition Tribunal and to amend the Combines Investigation Act and the Bank Act and other Acts in consequence thereof*, S.C. 1986, c. 26, s. 38.

The judicial interpretation of the required elements of the offence of price maintenance is well-settled. The element of "attempt," it is submitted, is a potential source of difficulty and this is all the more so in situations where there is an absence of a vertical distribution link between the accused and the person who is the target of the efforts to influence prices.

2.1 "Agreement, Threat, Promise or Any Like Means"

An attempt to influence prices upward or to discourage the reduction of prices is not sufficient for a conviction unless the accused did so in a manner which is an "agreement, threat, promise or any like means."

As to what is considered an "agreement," an issue that often arises is whether an agreement is binding. An agreement between a supplier and its customer concerning the resale prices of the customer is without any doubt an agreement within the meaning of the section.[7]

What is problematic in some cases is whether, as a matter of fact, there is an agreement. In *R. v. Cluett, Peabody, Canada Inc.*,[8] the evidence indicated that there was a conversation between a representative of the accused and one of its retailer at which the retailer was asked to stop selling shirts manufactured by the accused to another retailer who had resold them below the prevailing resale price. The trial judge held that there was no agreement but only a request to stop supplying the other retailer. In *R. v. Schelew*[9] an issue was whether a motion to increase rents passed at a meeting of members of a landlords' association was an "agreement." In dismissing the appeal of the Crown, LaForest J.A. (as he then was) held that there was not a binding agreement in the circumstances because the purpose of the meeting was to put pressure on the provincial government to change its policies and not to influence the rents charged by other landlords.

Where a threat is alleged as the manner by which an attempt was made to influence prices, the test is the effect on a reasonable person of the words used. In *R. v. David Downie*,[10] the court held that communications between the accused and its retailer would have caused the retailer concern that its supply of skis would be cut-off unless it raised resale prices. This conduct was held to constitute a threat within the meaning of section 38(1)(a) (now section 61(1)(a)).

In *R. v. Shell*, the trial judge held that a threat is:

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[7] See, for example, the leading case of *R. v. Moffats Ltd.* (1957), 7 D.L.R. (2d) 405 (Ont. C.A.); leave to appeal to S.C.C. refused.

[8] (1982), 64 C.P.R. (2d) 30 (Ont. Co. Ct.).

[9] (1982), 63 C.P.R. (2d) 140 (N.B.Q.B.); affirmed (1984), 78 C.P.R. (2d) 102 (N.B.C.A.).

[10] November 14, 1984, B.C. Co. Ct., unreported.

> "an urged course of action which carries with it some sanction or penalty if not carried out. It is a form of intimidation, fulmination, harrassment or warning which carries with it some form of penalty."[11]

The trial judge found that a threat was implicit in certain conversations by the words used and the tone of each.

A promise in the context of price maintenance may take many forms and may involve: shorter delivery time, larger quantities of a product, supply of another product which the reseller wants,[12] or higher discounts.[13]

The words "any like means" have been strictly interpreted. In *R. v. Philips Electronics Ltd.*,[14] the Ontario Court of Appeal held that an advertisement by the accused supplier of cordless television converters mentioning the resale of the product was not "any like means." In dismissing the appeal by the Crown, Goodman J.A. in the majority judgment held that the change in wording in the 1976 amendments to "any like means" from the words "any other means" in the 1951 Act is "a clear indication of the intention of Parliament to substantially restrict the type of attempts which constitute an offence under s. 38(1) (now S.61(1))."[15]

Goodman J.A. also held that the suggestion or publication in an advertisement of a resale price is not "any like means." In *R. v. Brown Shoe*,[16] the relaying by the accused, who was a supplier of shoes, to one of its retailers of complaints about that retailer's low pricing policy made by other retailers did not constitute "any like means."

2.2 "Attempt"

The element of "attempt" is analytically difficult to sort out. It is interrelated to the question of the *mens rea* requirement of the offence and is the key to the application of the offence to relationships where a vertical link is absent.

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[11] (1989), 24 C.P.R. (3d) 501 (Man.Q.B.) at p. 507; affirmed (1990), 29 C.P.R. (3d) 32 (Man. C.A.).

[12] *R. v. H.D. Lee* (1980), 57 C.P.R. (2d) 16 (Que. C.S.P.).

[13] *R. v. North Sailing Products Ltd.* (1987), 18 C.P.R. (2d) 497 (Ont. Dist. Ct.). The court held that the availability of a higher discount can be seen as a threat or as a promise.

[14] 116 D.L.R. (3d) 298 (Ont. C.A.); affirmed 126 D.L.R. (3d) 767 (S.C.C.). *Philips Electronics* was cited in *R. v. Euroclean Canada Inc.*, January 26, 1986, Ont. Dist. Ct., unreported, in support of the finding that the implementation of a master dealer program was not "like means" notwithstanding that the program would have an inhibiting effect on price reductions by subdealers.

[15] *Ibid.*, at p. 305.

[16] July 19, 1982, Ont. Prov. Ct., unreported.

The leading case on the element of "attempt" and its relation to the *mens rea* requirements of the offence is *Moffats*,[17] a case under the 1951 Act (as amended by R.S.C. 1952, c. 39, s. 4). Moffats, a manufacturer of home appliances, had established a co-operative advertising scheme whereby the Moffats agreed to pay its dealers up to 50% of the cost of advertisements if they did not, *inter alia*, advertise to sell appliances supplied by Moffats at less than the prices specified by Moffats. Moffats did not pay any cost of advertisements which advertised at less than the price specified.[18]

Moffats were charged with attempting by agreement, threat or promise or other means to induce George's Appliances Limited, a dealer, to resell refrigerators at prices not less than minimum prices specified by Moffats. Moffats was convicted at trial.

The main ground of appeal was whether the Crown had proved that Moffats intended to commit the offence. Moffats submitted that the purpose of the arrangement was to induce George's to advertise at not less than specified prices and not induce George's to resell at any particular price. Schroeder J.A. in his reasons on behalf of the Ontario Court of Appeal noted that the wording of the offence prohibited a certain act and the attempt to do that act: "(2) No dealer... by agreement, threat, promise or any other means whatsoever, require or induce or attempt to require or induce..." [Section 34(2), R.S.C. 1952, c. 314]. Schroeder J.A. considered relevant and decisive to the issue of *mens rea* the analysis of the *mens rea* requirement for conspiracy under the then section 498 of the *Criminal Code* (now section 45 of the *Competition Act*, R.S.C. 1985, chap. c-34). He quoted with approval the following passage from the reasons for judgment of Kerwin J. in the Supreme Court of Canada in *R. v. Container Materials*:

> "It was argued that it was not sufficient for the Crown to show an agreement or arrangement, the effect of which would be unduly to prevent or lessen competition, but that the agreement or arrangement must have been intended by the accused to have the effect. This is not the meaning of the enactment upon which the count was based. *Mens rea* is undoubtedly necessary but that requirement was met in these prosecutions when it was shown that the appellants intended to enter, and did enter, into the very arrangement found to exist."[19]

In addition Schroeder J.A. also considered the wording of the offence of attempt in the *Criminal Code*. He noted that the question which frequently arises in charges under that provision of the *Criminal Code* of whether an accused had done any acts beyond mere preparation was not in issue in the case before him.

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[17] *Supra*, note 7.

[18] The use of a co-operative advertising programme to control resale prices is not uncommon: see *R. v. A & M Records of Canada Ltd.* (1980), 51 C.P.R. (2d) 225 (Ont. Co. Ct.) [records and pre-recorded tapes] and *R. v. Church and Co. (Canada) Ltd.* (1980), 52 C.P.R. (2d) 22 (Ont. Prov. Ct.) [shoes].

[19] [1942] 1 D.L.R. 529 (S.C.C.) at p. 538; affirming [1941] 3 D.L.R. 145 (Ont. C.A.).

Schroeder J.A. in *Moffats* concluded that:

> "...*mens rea* is established in this case once it is shown that the appellant advertently entered into an agreement which had the effect or would have the effect of inducing George's Appliances Ltd. to resell the appellant's commodities at a price not less than a minimum price specified by it in the co-operative advertising agreement. If I am right in this view, then it follows logically that for the appellant to have done one of the acts which conjointly would constitute the consummated offence, with the intent of doing all such acts was an attempt to commit that offence."[20]

He went on to say that:

> "The question whether the agreement or arrangement which gives rise to this prosecution comes within the words of s. 34 prohibiting an attempt to induce any other person directly or indirectly to resell an article or commodity at a price not less than a minimum price specified by the appellant is a pure question of fact rather than intention..."

Schroeder J.A. confirmed the finding of the trial Magistrate that an inducement to advertise at not less than a specified price is an attempt to induce the reselling of the good at not less than the specified price:

> "As to the first three grounds of appeal advanced before us, namely that the act of the appellant which is said to constitute the offence was directed to inducing dealers to do more than advertise for sale and not to resell at less than specified minimum prices and that s. 34 did not extend to such a case, the simple and conclusive answer to that contention is that if an agreement binding a person to advertise commodities or sale at not less than specific designated prices causes such persons to resell such commodities at not less than that price, or has the effect of exerting an influence upon or creating an inducement to such persons to resell such commodities at not less than the price so designated, then the agreement assuredly falls within the prohibition of that section. It makes no difference whether this is a direct or indirect result of the operation of that scheme."[21]

Schroeder J.A. found that there was ample evidence at trial that the dealers generally did not sell below the advertised price.

Applying the analysis in *Moffats*[22] to the present wording of the offence, the Crown must prove the following:

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[20] *Supra*, note 7, at p. 411.

[21] *Ibid.*, at p. 415.

[22] See also the majority judgment of Schroeder J.A. in *R. v. Campbell* (1964), 46 D.L.R. (2d) 83 (Ont. C.A.) at 125; affirmed (1966), 58 D.L.R. (2d) 673 (S.C.C.). Schroeder J.A. found that the "logical effect" of a complex arrangement involving an agent of the supplier, distributors and ultimate buyers of surgical blades was an attempt to induce resale prices of the distributors.

(a) an accused intended and did enter an agreement, make a threat, make a promise or do anything which could be considered to be "any like means"; and

(b) whether or not intended by the accused, the agreement, threat, promise, or any like means has the effect or would have the effect of influencing the price in the requisite direction.

In *Philips Electronics*[23] an issue on appeal was the interpretation of the provisions dealing with suggested retail price and publication of an advertisement mentioning a resale price in sections 38(3) and 38(4) respectively (now sections 61(3) and 61(4)). According to Goodman J.A., these provisions, which are discussed below, relieved the burden of the Crown to show that the suggestion or publication of a resale price is an attempt to influence prices in the requisite direction since, for example, the suggestion of a resale price is equally consistent with an attempt to influence prices upward as with an attempt to influence its customers not to raise prices.

2.3 "Any Other Person Engaged in Business"

As a result of the 1976 amendments, the offence of price maintenance, which heretofore applied only to vertical relationships between a seller and a dealer who are connected, directly or indirectly in the process of supplying a good to the ultimate buyer, applies to horizontal relationships as well. Properly speaking, the offence of price maintenance may apply even in the absence of a vertical or horizontal relationship.

Many commentators were highly critical of this change. For example, Flavell questioned the purpose and wisdom of removing the vertical distribution link which underpinned the offence of resale price maintenance:

> "There appears to be no connection or bargaining power required as between the first and second person, nor need they be involved in commerce in the same or related products. In an unprofitable business one can image all kinds of attempts (by representations to government, by warnings of imminent bankruptcy and the like) to generally influence upward a price structure but not vis-a-vis any persons subject in any particular way to the bargaining power of the person making the representations. By removing the vertical distributing link, long essential to the concept of resale price maintenance in Canada and in the United States, an entirely new, and arguably unnecessary, sphere of activity is added to the criminal sector under the guise of blocking a couple of identifiable, easily remediable loopholes."[24]

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[23] *Supra*, note 13.

[24] Michael Flavell, *Canadian Competition Law* (Toronto: McGraw-Hill Ryerson Limited, 1979), p. 295.

Few cases have come before the courts.[25] This suggests that the government has taken notice of the criticism or that there are few horizontal relationships that come within the ambit of the offence. In *R. v. Campbell*[26] a car rental company was convicted of price maintenance for threatening two competitors with a further lowering of prices in the midst of a price war in the car rental business in Kelowna. Specifically, the accused threatened to use a car rental company "as a club" if the price war persisted. He was unsuccessful in his earlier efforts to bring the price war to an end. He presented to his competitors his tariff of rates in advance to no avail. He even told his competitors that at the prevailing rates, they were going to go broke.

It is submitted that in convicting the accused, the trial judge would have concluded that the competitors would have taken heed of the threat in the circumstances where there was a disastrous price war of some considerable duration. In face of this threat, it would not have been unreasonable for a competitor to be influenced not to lower his prices.

In *R. v. Schelew*[27] at a meeting of a landlord association was held at which the persons voted to increase rents three times over the following year. In acquitting all the accused, Barry J. observed that in the cases he reviewed, there was some power exerted by the accused to achieve the desired result:

> "In all cases I have been able to find, commodities were involved but services are included. The "influencor" possessed some means or power to influence the desired result. The accused had no such power. "Influence" has many meanings but I would doubt that in a criminal case, it would include 'suggestion'."[28]

On appeal by the Crown, the New Brunswick Court of Appeal[29] held that there was sufficient doubt that the vote at the meeting constituted an agreement. LaForest J.A. accepted evidence that the purpose of the meeting was not to influence landlords to increase rents but to put pressure on the government to change its certain policies which adversely affect landlords.

Angers J.A. dismissed the appeal on different grounds. In his view, in order for horizontal maintenance by agreement to be illegal, the effect of the agreement must constrain the persons whose conduct is being influenced:

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[25] See, Gordon Kaiser and Ian Nielsen-Jones, "Recent Developments in Canadian Law: Competition Law," (1986), 18 *University of Ottawa Law Review* 401, at 440 where it is reported three cases have come before the courts, resulting in two convictions and one acquittal.

[26] (1979), 51 C.P.R. (2d) 284 (B.C. Co. Ct.).

[27] *Supra*, note 9.

[28] *Ibid.*, at p. 150.

[29] *Supra*, note 9.

> "Finally it is not every attempt to manipulate (upward or downward) or maintain prices that is prohibited but only those attempts made by "agreement, threat, promise or any like means." Such an attempt achieved by threat or promise directed at persons may be, at least in some instances, a tangible concept, but where there is no vertical distribution link, it is difficult to conceive an agreement between horizontal entities which could constitute the attempt prohibited by the section. Indeed, it seems to me that an agreement between horizontal entities must, if it is to constitute an attempt to alter the prices at which other persons supply their product, have some constraining effect on those other persons. It must be of such magnitude as to be capable of affecting prices in such a way as to restrict the freedom of trade of suppliers who are not part of the agreement."[30]

Angers J.A. found that there was an agreement:

> "...there is no doubt that the accused Schelew attempted to persuade other landlords in the Moncton area to increase the price of their rentals. I am also inclined to think that some landlords, including the accused Schelew, agreed to increase the price of their rental accommodations and to try to persuade other landlords to do the same. These attempts to persuade other landlords to raise their prices were effected by providing them with information, statistics and good management advice. I am not about to conclude that any attempt by a group of landlords to persuade other landlords to raise their prices is illegal."[31]

Angers J.A. went on to say that the agreement of some landlords did not have the effect of influencing the rents charged by other landlords:

> "Here there was no attempt to bind or restrict the right of other landlords to rent their premises at the price they chose. The evidence... clearly shows that no landlord felt bound by a majority decision of their association, let alone by any agreement of other landlords. At best, there was an attempt to influence landlords to raise their rents but no agreement of sufficient magnitude to affect prices so as to restrict the freedom of other landlords to fix their own prices."[32]

Angers J.A. did not say whether the agreement was an attempt to influence the rents charged by the landlords attending the meeting. It is submitted that he would have concluded that the agreement did not have a constraining effect on the landlords present at the meeting.

R.J. Roberts writing in 1980 suggested that the most severe restriction in applying the offence of price maintenance to horizontal conduct is the element of attempt:

> "This element of the offence, might in horizontal price maintenance case, be held to make motive of primary importance. As a result, agreements or other practices having the effect of influencing upward or discouraging a reduction of price in an industry would not appear to be outlawed under s. 38(1)(a) unless it was shown that

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[30] *Ibid.*, at p. 111.

[31] *Ibid.*, at p. 111.

[32] *Ibid.*, at p. ?.

> the intent of the parties was, in fact, to restrict price competition. Effect would not be enough."[33]

In a footnote to the above-quoted passage, Roberts noted that proving effect was sufficient in price maintenance cases involving vertical relationships and wondered whether proving effect was sufficient in horizontal relationships.

It is submitted that the offence of price maintenance, in general, does not apply to a horizontal relationship or any relationship where there is an absence of a vertical distribution link because it would be difficult to establish a "causal" link between a prohibited means and the prices of a person who is not part of the same vertical distribution process as the accused. The concern that as a result of the 1976 amendments, the offence has become too far-reaching is unsupportable.

2.4 Suggested Resale Prices and Published Resale Prices

Under section 61(3) of the *Competition Act* a suggestion by a supplier of a resale price to a reseller is proof of an attempt to influence that person unless it is made clear there is no obligation to accept the suggestion and that there would not be any negative consequences from not implementing the suggestion. Under section 61(4) an advertisement containing a suggested resale price is proof of an attempt to influence the reseller unless the advertisement makes clear that the product may be sold at a lower price. By section 61(5) these provisions do not apply to a price appearing on a product, its package or container.

It is well-settled that the suggestion of a resale price (or the publication of a suggested price), in and of itself, is not an offence. As it was made clear in *Philips Electronics*,[34] the statutory provisions relieve the burden on the Crown to prove the element of "attempt." For a conviction, it is necessary still to prove that the attempt was effected by one of the prohibited means.

3.0 REFUSAL TO SUPPLY

The offence of refusal to supply or otherwise discriminate is concerned with: (a) a refusal to supply; (b) or, otherwise discriminate; (c) because of low pricing policy.

3.1 "Person"

The offence of refusal to supply like the offence of price maintenance applies to any person who is engaged in a business of producing or supplying a product. In *R. v. Pacific Energy Woodstoves Ltd.* the court held that the offences of price maintenance and refusal to supply are not intended to cover the conduct of an agent of a person who is charged: "... that in my view is intended to deal with the person, be it an individual or a corporation, that is the entrepreneur as opposed to the servant, employee, or agent of a participant."[35] The charges against the individual defendant, who was charged as an "agent of a participant" as the term is defined in section 45 of the *Competition Act* were dismissed. It is submitted that the underlying reasoning is that the individual was not in the business of producing or supplying a product. The court was not asked to consider whether the individual defendant could have been charged as an aider or abettor under the *Criminal Code*.

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[33] R.J. Roberts, *Anticombines and Antitrust: The Competition Law of Canada and the Antitrust Law of the United States* (Toronto: Butterworths, 1980), p. 280.

[34] *Supra*, note 13.

3.2 "Directly or Indirectly" Refuse to Supply

"Product," which is defined in the Act to include an article and a service, is given its ordinary meaning. In *R. v. Grange*[36] the court held that a refusal to supply a brand of mattresses falls within the offence notwithstanding the supplier continued to supply other brands of mattresses.

In *R. v. Great West Imports Ltd.*[37] the court held that to prove a refusal to supply, it is unnecessary to establish that the supplier had refused a request to supply which was made after the customer was cut-off.

The meaning of "indirect" was considered in *R. v. Sunoco*.[38] At trial, the Crown submitted that Sunoco had, in effect, refused to supply gasoline to its dealer because by freezing price support at a specified resale price level, it had limited the dealer's profit when the price fell below that level. German D.C.J. held that there was no indirect refusal to supply because Sunoco continued to supply gasoline to the dealer after the price support, known as "temporary voluntary allowance or T.V.A.," was frozen and there was another relevant way in which the station can make up for any loss profits. She remarked that, in some circumstances, these actions might amount to an indirect refusal to supply.

3.3 "Otherwise Discriminate"

In addition to a refusal to supply, conduct which amounts to discrimination, other than a refusal to supply, is prohibited. It would seem natural to interpret this alternative branch of the offence to mean that it is sufficient to show that there was discrimination, other than a refusal to supply, and the discrimination was because of a low pricing policy.[39]

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[35] April 24, 1987, B.C. Prov. Ct., unreported, at p. 3.

[36] (1979), 40 C.P.R. (2d) 214 (B.C. Co. Ct.).

[37] September 28, 1984, Man. Q.B. unreported.

[38] (1986), 11 C.P.R. (3d) 557 (Ont. Dist. Ct.); affirmed May 25, 1989, Ont. C.A., unreported.

In *Sunoco* the trial judge rejected the submission of the Crown that there was discrimination because the dealer's T.V.A. was frozen while other dealers continued to receive the T.V.A. The court stated:

> "In order to find that the accused discriminated against Singh, I believe that it is necessary to have some evidence that other dealers initiated downward pricing or matched secondary competition and did not have their T.V.A. frozen before it could be said that Sunoco discriminated against the Singh station."[40]

It is respectively submitted that a requirement to show that other dealers who initiated downward pricing did not have their T.V.A. frozen would confuse the element of refusal or otherwise discriminate with the element of showing that the refusal or discrimination was by reason of low pricing policy. Since discrimination is an alternative to refusal, the logic of the requirement is that in cases of a refusal, it would be necessary in proving the element of refusal, to prove both that there was a refusal to supply and that supply to other price discounters was not cut-off. Evidence that other price discounters were not cut-off is relevant only to the element of low pricing policy. Such evidence on conduct towards other customers, however, is not necessary. For example, an admission, without any reference to other customers, that the refusal was by reason of the low pricing policy of the customer in question would suffice.

No offence is committed if discrimination was based on volume of purchases. In *R. v. North Sailing Products Ltd.*, the court held that the failure to offer a preferential discount to a dealer was not discrimination because the volume of purchases by that dealer was lower than that of dealers who received the preferential discount: "That is a legitimate and perfectly lawful form of discrimination, based on the volume of purchases."[41] It appears that the court had in mind the price discrimination provisions in section 50(1)(a) of the *Competition Act* which permits price discrimination based on the volume of purchases.

3.4 "Because of the Low Pricing Policy of That Other Person"

The legal issue with respect to this element is whether it must be proven that the refusal or discrimination is by reason only of the low pricing policy. In *R. v. Griffith Saddlery & Leather Ltd.* the trial judge was of the view that for a conviction, it must be proved that the refusal to supply was by reason only of the low pricing policy:

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[39] *R. v. North Sailing Products Ltd., supra*, note 12.

[40] *Supra*, note 37, at p. 568.

[41] *Supra*, note 12, at p. 506.

> "In order to find the defendant corporation guilty of that offence as charged I must be satisfied beyond a reasonable doubt that sales to Windever were discontinued for that reason and that reason only, namely, because of the low pricing policy."[42]

With respect to the count in issue, the trial judge held that the refusal to supply was not because of the low pricing policy but because the accused did not want to antagonize a long-standing and valued client who had expressed displeasure with the presence of Windever in its market area. It is respectively submitted that the above-quoted conclusion of law should be confined to the facts of that case. It is not difficult to countenance that there is often more than one reason that a supplier would give to terminate its relationship with a customer who is engaging in discounting.

3.5 Statutory Defences

The Act expressly provides for four defences to a charge of refusing to supply if there was a reasonable belief that there was loss-leadering, bait and switch selling, misleading advertising, or failing to provide the expected level of service. The onus is on the accused to establish the defence on the balance of probabilities.[43] It is curious that evidence of such belief is not a defence to a charge of otherwise discriminating.

Evidence of such belief is not, however, an absolute defence to a charge of refusing to supply. The Act provides that "no inference unfavourable" shall be drawn from evidence of refusing to supply if there was a reasonable belief of loss-leadering, bait and switch selling, misleading advertising or not providing the expected level of service. This has been interpreted in *R. v. William E. Coutts Ltd.* to mean that loss-leadering is not an absolute defence:

> "On a strict reading it would appear to have application only where the Crown is seeking to rely solely on an inference to be drawn from the evidence adduced and that the accused would not benefit therefrom where the Crown adduced acceptable direct testimony of the refusal or counselling to refuse for the objectionable reason specified."[44]

In other words, a court is prohibited from drawing an unfavourable inference from the evidence of refusal to supply if there was a reasonable belief of a practice of loss-leadering, bait and switch selling, misleading advertising, or not providing the expected level of service. If there is some other evidence of refusing to supply because of low pricing policy, the statutory defences would not be effective.

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[42] (1986), 14 C.P.R. (3d) 389 (Ont. Prov. Ct.), at p. 395.

[43] *R. v. Salomon Canada Sport Ltee.* (1986), 28 C.C.C. (3d) (C.A.); reversing March 19, 1984, Que. C.S.P.

[44] (1966), 52 C.P.R. 21 (Ont. H.C.), at p. 24; affirmed [1968] 1 O.R. 549 (Ont. C.A.).

There must be a "practice" of which the accused had a reasonable belief. "Practice" denotes more than an isolated act or acts. In *Coutts* the trial judge held that an offer to every purchaser of a card to buy another card for one cent is a practice of loss-leadering in the circumstances where there was extensive sales with uniformity and consistency of sales terms over a period of a week.[45]

As the case of *Salomon*[46] makes clear, it is the reasonableness of the belief of the accused (and any one upon whose report it depended) that is the essence of the statutory defences. The test of reasonableness is an objective of taking into account the (objective) facts that were known to the accused at the time it made the decision to refuse to supply. The defences of bait and switch selling and misleading advertising were successfully used in *R. v. Sony Canada Ltd.*[47] where the executives making the decision to refuse to supply a dealer were found to be entitled to reply on a report by some other member of the company about such dealer practices.

Loss-Leadering: The trial judge in *R. v. Philips Electronics*[48] defined "loss-leaders" to mean selling at below cost to the dealer and rejected the submission that it should be selling below normal cost which includes normal mark-up. The Court of Appeal expressly refrained from agreeing or disagreeing on this point since it was unnecessary to do so for the disposition of the appeal. The definition of "loss-leaders" of the *Philips Electronics* trial judgment was adopted in *R. v. H.D. Lee*[49] and the trial decision in *Salomon*.[50]

Morand J. in *Philips Electronics*[51] gave two reasons for rejecting the submission of defence counsel that in defining cost, some consideration should be given to the normal mark-up or at least the normal cost of business. First, he said the words in the statute must be given their ordinary meaning and the words of the statutory provision clearly means "selling at less than actual cost." Furthermore, the trial judge commented that if the Legislature intended the cost of doing business to be considered, it would have said so in the legislation. Secondly, he was of the view that if the cost of business was a relevant consideration, the courts would be faced with a formidable task, and in some cases, an impossible task:

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[45] *Ibid.*, at p. 26.

[46] *Supra*, note 42, at p. 248.

[47] (1987), 16 C.P.R. (3d) 50 (Ont. Dist. Ct.).

[48] (1966), 52 C.P.R. 225 (Ont. H.C.); varied (1968), 2 D.L.R. (3d) 558 (Ont. C.A.).

[49] *Supra*, note 11.

[50] *Supra*, note 42.

[51] *Supra*, note 47, at p. 227.

> "...the Court would have to make a thorough examination of the company charged to establish a *pro rata* cost of doing business on that particular article and then determine whether the article was sold at less than the actual dollar cost plus the cost of doing business on that article."[52]

It is submitted that defining "loss-leaders" to mean selling below cost to the dealer is difficult to reconcile with the following words of the provision: "...loss-leaders, that is to say, not for the purpose of making a profit thereon but for purposes of advertising." The words of the provision expressly require consideration of whether there was selling not for the purpose of making a profit but for the purposes of advertising. It would be too simplistic to say that profit on the sale of a product means the difference between the selling price of an article and the price paid by a dealer from its supplier.

In acquitting the accused, Beauregard J.A. of the Quebec Court of Appeal in *Salomon* held that the net cost to the dealer is the relevant consideration: "In order to determine the merchant's intention, consideration must be given not only to the price that the merchant pays his supplier but also to his net cost price."[53]

Tyndale J.A. was of the same view:

> "I gather that the correct method of calculating 'profit' as the word is used... is subject to debate (and consequently the calculation of 'loss' in 'loss-leaders'); whether the base figure is the merchant's purchased price with or without additions for overhead and the like; in other words, whether reference is to gross profit or to net profit. I should have thought that net profit makes more sense, and my brother Beauregard has expressed that opinion. It may not be necessary formally to decide the point in this appeal; if there is a doubt, it should be resolved in favour of appellant Salomon."[54]

The difficulty in calculating net profit of a product should not be overlooked. As many commentators have observed,[55] retailers do not allocate costs by product. This difficult should not, however, be an obstacle to proving loss-leadering. As noted above, the accused needs to show only that it believed and had reasonable cause to believe that the dealer was engaging in a practice of loss-leadering. It would be a heavy burden on an accused if it is required to do a precise calculation of net profit on a product sold by a dealer who is unrelated.

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[52] *Ibid.*, at p. 228.

[53] *Supra*, note 42, at p. 248.

[54] *Ibid.*, at p. 250.

[55] *Ibid.*, at p. 250.

It has been stated that loss-leadering as a statutory defence is a shield rather than a sword. What this means is that a supplier may not stipulate that it would consider a dealer to be engaging in loss-leadering if the dealer sold below the minimum resale prices suggested by the supplier.[56] All this is clear from the wording of the statutory defences which states that they apply only as defences to a charge of refusing to supply and not to a charge of price maintenance.

Bait and Switch Selling: This defence was described in the following terms in *H.D. Lee*:

> "The term describes the practice by a merchant of attracting customers to his store by advertising a product at a price which includes very little profit or not profit at all with a view of selling instead to these customers other brands or similar articles at a higher price or greater profit. This is usually done by keeping a very low or incomplete stock of the product on hand."[57]

Misleading Advertising: The legal issues arising from the use of this defence are common to the other statutory defences.

Expected Level of Service: The test of the expected level of service is not to be determined from the standpoint of the supplier but from the point of view of the customers who are purchasing from the dealer. The test of expected level of service was described in the following terms in *H.D. Lee*:

> "However desirable from the supplier's standpoint, is the amount of servicing and promotion a retailer will give to his product, the test of para. 5(d) is not the level of servicing which the supplier or manufacturer might expect but rather the level of servicing which the purchaser of such product might expect."[58]

Evidence of complaints from retail customers would have been sufficient in *H.D. Lee*.

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[56] *R. v. Sunbeam Corporation Ltd.* (1966), 59 D.L.R. (2d) 321 (Ont. H.C.); varied (1967), 62 D.L.R. (2d) 75 (Ont. C.A.); appeal allowed in part (1968), 1 D.L.R. (3d) 161 (S.C.C.).

[57] *Supra*, note 11, at p. 197.

[58] *Ibid.*, at p. 198.

Table 1

NUMBER OF PROSECUTIONS FOR PRICE MAINTENANCE AND/OR REFUSAL TO DEAL

Year ending March 31	
1951-1955	2
1956-1960	1
1961-1965	10
1966-1970	7
1971-1975	15
1976-1980	47
1981-1985	58
1986-1990	44

Sources: Margaret Sanderson and W.T. Stanbury, *Competition Policy in Canada: The First Hundred Years* (Ottawa: Department of Consumer and Corporate Affairs, 1989), and Director of Investigation and Research, *Annual Report*, 1989/90.

Appendix A

TEXT OF PRICE MAINTENANCE LEGISLATION AND AMENDMENTS THERETO

1. *An Act to Amend the Combines Investigation Act*, S.C. 1951 [2nd sess.], c. 30, s. 1 amending *Combines Investigation Act*, R.S.C. 1927, c. 26.

> 37A. (1) In this section "dealer" means a person engaged in the business of manufacturing or supplying or selling any article or commodity.
>
> (2) No dealer shall directly or indirectly by agreement, threat, promise or any means whatsoever, require or induce or attempt to require or induce any other person to resell an article or commodity
>
> (a) at a price specified by the dealer or established by agreement,
> (b) at a price not less than a minimum price specified by the dealer or established by agreement,
> (c) at a markup or discount specified by the dealer or established by agreement,
> (d) at a markup not less than a minimum markup specified by the dealer or established by agreement, or
> (e) at a discount not greater than a maximum discount specified by the dealer or established by agreement, whether such markup or discount or minimum markup or maximum discount is expressed as a percentage or otherwise.
>
> (3) No dealer shall refuse to sell or supply an article or commodity to any other person for the reason that such other person
>
> (a) has refused to resell or to offer for resale the article or commodity
> (i) at a price specified by the dealer or established by agreement;
> (ii) at a price not less than a minimum price specified by the dealer or established by agreement,
> (iii) at a markup or discount specified by the dealer or established by agreement,
> (iv) at a markup not less than a minimum markup specified by the dealer or established by agreement, or
> (v) at a discount not greater than a maximum discount specified by the dealer or established by agreement, or
> (b) has resold or offered to resell the article or commodity
> (i) at a price less than a price or minimum price specified by the dealer or established by agreement,
> (ii) at a markup less than a markup or minimum markup specified by the dealer or established by agreement, or
> (iii) at a discount greater than a discount or maximum discount specified by the dealer or established by agreement.
>
> (4) Every person who violates subsection two or three is guilty of an indictable offence and is liable on conviction to a penalty not exceeding ten thousand dollars or to two years' imprisonment, or if a corporation to a penalty not exceeding twenty-five thousand dollars.
>
> (5) The Commissioner has authority to institute and conduct an inquiry into all such matters as he considers necessary to inquire into with a view of determining whether this section has been or is being violated and to make a report thereon in writing

> to the Minister, and for such purposes the Commissioner has all the powers, authority, jurisdiction and duties that are conferred upon him by this Act, including sections sixteen and seventeen, with respect to an inquiry as to whether a combine exists or is being formed.
>
> (6) A report of an inquiry under this section shall be dealt with in the same manner as a report of an inquiry or investigation under this Act as to whether a combine exists or is being formed.

2. *An Act to Amend the Combines Investigation Act and the Criminal Code*, S.C. 1952, c. 39, s. 4.

The amendment renumbered the provision as section 34 and repealed and substituted subsections 4, 5 and 6 with a new subsection 4:

> (4) Every person who violates subsection two or three is guilty of an indictable offence and is liable on conviction to a fine in the discretion of the court or to imprisonment for a term not exceeding two years or to both.

3. *An Act to Amend the Combines Investigation Act and the Criminal Code*, S.C. 1960, c. 34, s. 14.

> (5) Where, in a prosecution under this section, it is proved that the person charged refused or counselled the refusal to sell or supply an article to any other person, no inference unfavourable to the person charged shall be drawn from such evidence if he satisfies the court that he and any one upon whose report he depended had reasonable cause to believe and did believe
>
> (a) that the other person was making a practice of using articles supplied by the person charged as loss-leaders, that is to say, not for the purpose of making a profit thereon but for the purposes of advertising;
> (b) that the other person was making a practice of using articles supplied by the person charged not for the purpose of selling such articles at a profit but for the purpose of attracting customers to his store in the hope of selling them other articles;
> (c) that the other person was making a practice of engaging in misleading advertising in respect of articles supplied by the person charged; or
> (d) that the other person made a practice of not providing the level of servicing that purchasers of such articles might reasonable expect from such other person.

4. *Combines Investigation Act*, R.S.C. 1970, c. C-23

The section was renumbered as section 38 as part of the 1970 revision of the Statutes of Canada.

5. *An Act to Amend the Combines Investigation Act*, S.C. 1974-75-76, c. 76, s. 18(1)

The amendment repealed the entire section and replaced it with the following:

> 38. (1) No person who is engaged in the business of producing or supplying a product, or who extends credit by way of credit cards or is otherwise engaged in a business that relates to credit cards, or who has the exclusive rights and privileges conferred by a patent, trade mark, copyright or registered industrial design shall, directly or indirectly,

(a) by agreement, threat, promise or any like means, attempt to influence upward, or to discourage the reduction of, the price at which any other person engaged in business in Canada supplies or offers to supply or advertises a product within Canada; or
(b) refuse to supply a product to or otherwise discriminate against any other person engaged in business in Canada because of the low pricing policy of that other person.

(2) Subsection (1) does not apply where the person attempting to influence the conduct of another person and that other person are affiliated companies or directors, agents, officers or employees of

(a) the same company, partnership or sole proprietorship, or
(b) companies, partnerships or sole proprietorships that are affiliated,

or where the person attempting to influence the conduct of another person and that other person are principal and agent.

(3) For the purposes of this section, a suggestion by a producer or supplier of a product of a resale price or minimum resale price in respect thereof, however arrived at, is, in the absence of proof that the person making the suggestion, in so doing, also made it clear to the person to whom the suggestion was made that he was under no obligation to accept the suggestion and would in no way suffer in his business relations with the person making the suggestion or with any other person if he failed to accept the suggestion, proof of an attempt to influence the person to whom the suggestion is made in accordance with the suggestion.

(4) For the purpose of this section, the publication by a supplier of a product other than a retailer, of an advertisement that mentions a resale price for the product is an attempt to influence upward the selling price of any person into whose hands the product comes for resale unless the price is so expressed as to make it clear to any person to whose attention the advertisement comes that the product may be sold at a lower price.

(5) Subsections (3) and (4) do not apply to a price that is affixed or applied to a product or its package or container.

(6) No person shall, by threat, promise or any like means, attempt to induce a supplier, whether within or without Canada, as a condition of his doing business with the supplier, to refuse to supply a product to a particular person or class of persons because of the low pricing policy of that person or class of persons.

(7) For the purposes of subsection (2),

(a) a company is affiliated with another company if
    (i) one is a subsidiary of the other
    (ii) both are subsidiaries of the same company
    (iii) both are controlled by the same person, or
    (iv) each is affiliated with the same company; and
(b) a partnership or sole proprietorship is affiliated with another partnership, sole proprietorship or a company if both are controlled by the same person.

(7.1) For the purposes of this section, a company is deemed to be controlled by a person if shares of the company carrying voting rights sufficient to elect a majority of the directors of the company are held, other than by way of security only, by or on behalf of that person.

(8) Every person who violates subsection (1) or (6) is guilty of an indictable offence and is liable on conviction to a fine in the discretion of the court or to imprisonment for five years or to both.

(9) Where, in a prosecution under paragraphs (1)(b), it is proved that the person charged refused or counselled the refusal to supply a product to any other person, no inference unfavourable to the person charged shall be drawn from such evidence if he satisfies the court that he and any one upon whose report he depended had reasonable cause to believe and did believe

(a) that the other person was making a practice of using products supplied by the person charged as loss-leaders, that is to say, not for the purpose of making a profit thereon but for purposes of advertising;
(b) that the other person was making a practice of using products supplied by the person charged not for the purpose of selling such products at profit but for the purpose of attracting customers to his store in the hope of selling them other products;
(c) that the other person was making a practice of engaging in misleading advertising in respect of products supplied by the person charged; or
(d) that the other person made a practice of not providing the level of servicing that purchasers of such products might reasonably expect from such other person.

6. *An Act to establish the Competition Tribunal and to amend the Combines Investigation Act and the Bank Act and other Acts in consequence thereof*, S.C. 1986, c. 26, s. 38.

The amendment repealed subsections 38(7) and (7.1) and an expanded definition of affiliated companies was added to S.2.

7. *An Act to establish the Competition Tribunal and to amend the Combines Investigation Act and the Bank Act and other Acts in consequence thereof*, R.S.C. 1985, c. 19 (2nd Supp), s. 36.

This is the 1985 revision to the Statutes of Canada. Section 38 became S. 61 effective January 12, 1988.

Chapter 16

RECENT DEVELOPMENTS IN THE ECONOMICS OF EXCLUSIONARY CONTRACTS

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1.0 INTRODUCTION

Exclusionary practices have long been a concern of antitrust law. There are sound and innocuous business reasons for many kinds of exclusionary practices, but there has also been considerable worry that they might have more sinister reasons. An early example is the 1922 *United Shoe Machinery* case, in which the United States Supreme Court objected to certain clauses in the contracts used for leasing shoe-making machinery. The leases, explained the Court, had "the practical effect" of "specific agreements not to use the machinery of a competitor."[1] The specific exclusionary clauses banned were:

> (1) the restricted use clause, which provides that the leased machinery shall not... be used upon shoes... upon which certain other operations have not been performed on other machines of the defendants; (2) the exclusive use clause, which provides that if the lessee fails to use exclusively machinery of certain kinds made by the lessor, the lessor shall have the right to cancel the right to use all such machinery so leased; (3) the supplies clause, which provides that the lessee shall purchase supplies exclusively from the lessor; (4) the patent insole clause, which provides that

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[*]. The paper was written when the author was visiting at the Center for the Study of the Economy and the State, University of Chicago. He would like to thank Stanley Ornstein and Emmanuel Petrakis for their comments.

[1] *United Shoe Machinery Corp. v. U.S.*, 258 U.S. 451, 458 (1922).

> the lessee shall only use machinery leased on shoes which have had certain other operations performed upon them by the defendants' machines; (5) the additional machinery clause, which provides that the lessee shall take all additional machinery for certain kinds of work from the lessor or lose his right to retain the machines he has already leased; (6) the factor output clause, which requires the payment of a royalty on shoes operated upon by machines made by competitors; (7) the discriminatory royalty clause providing lower royalty for lessees who agree not to use certain machinery on shoes lasted on machines other than those leased from the lessor.[2]

There have been a number of other cases in which exclusionary agreements were held to be bad conduct. In *Klor's Inc. v. Broadway-Hale Stores, Inc.*,[3] Klor's, a department store, complained that Broadway-Hale, another department store, had demanded that manufacturers and distributors of major appliance brands not deal with Klor's. They complied, although the appliances were still sold to other nearby retailers. The U.S. Supreme Court ruled Broadway-Hale's action to be a group boycott. In *Lorain Journal Co. v. U.S.*,[4] a monopolistic newspaper faced competition for advertising from a new radio station. The newspaper responded by refusing to print advertisements from anyone who advertised with the ratio station. The Supreme Court found that this was an attempt to monopolize, and illegal under Section 2 of the Sherman Act. In *Packard Motor Car Co. v. Webster Motor Car Co.*,[5] on the other hand, exclusion was allowed. One of several Packard dealers in a town told Packard that he would quit unless Packard made him the exclusive dealer, shutting out another dealer named Webster. The appeals court reversed the district court's finding of a conspiracy in restraint of trade in violation of Section 2 of the Sherman Act.[6]

If it is decided that exclusion should be prohibited, there are important practical problems in determining which contracts are effectively exclusionary, or in detecting unwritten exclusionary agreements. The first step, however, is to decide whether harm is caused even by naked exclusion: a trader's straightforward requirement that anyone who trades with him must trade with him alone, when there are no apparent efficiency reasons for such a requirement. Is anything wrong with naked exclusion?

The naive view is that exclusion agreements are bad because they increase monopoly profits by shutting out competition. This ignores the fact that even under monopoly no consumer will sign away a valuable right unless he receives some kind of compensation, something noted by Director and Levi as long ago as 1956. Suppose, for example, that a customer is willing to pay up to $10 for a product, but no more. A monopolist could then charge a price of $10, but if the consumer must sign the exclusion contract on top of the $10, he will balk and refuse to buy. The monopolist cannot have both the $10 and the exclusion contract; to obtain the exclusion contract, he must lower the price to, say, $8. The question is then whether exclusion is worth $2 to the monopolist.

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[2] *United Shoe Machinery Corp. v. U.S.*, 258 U.S. 456-8 (1922).

[3] 359 U.S. 207, 212-13 (1959).

[4] 342 U.S. 143 (1951).

[5] 243 F2d. 418, 420, 421 (D.C. Cir. 1957).

[6] Other cases include *Standard Oil Co. of California (Standard Stations) v. United States*, 337 U.S. 293 (1949) and *Federal Trade Commission v. Motion Picture Advertising Service Co.*, 344 U.S. 392 (1953).

Director and Levy raised this question, but they did not answer it. The first step of the formal modelling will be to show that the monopolist will not find it worthwhile to sacrifice profit in return for exclusion unless the situation involves special complications. These complications can be of three kinds: "efficiency reasons," "price discrimination reasons," and "strategic reasons."

Efficiency reasons for exclusion are unobjectionable from the viewpoint of public policy, since they increase economic efficiency rather than decrease it. They include any reason which raises the quality or lowers the cost of the product. A high-quality automaker, for example, might not want a dealer to sell both its own cars and another automaker's shoddy cars from the same lot, for fear of degrading its image of high quality. Efficiency reasons are numerous and varied; for a survey see Ornstein (1989).

Price-discrimination reasons for exclusion depend on pre-existing monopoly power, which can use exclusion to fully exploit the gains from trade.[7] Price discrimination is a different flavor of argument than either efficiency or strategy, because price discrimination can either help or hurt efficiency and consumers, depending on the circumstances. This makes its policy implications unclear.

Strategic reasons for exclusion exploit lack of cooperation among the parties offered the exclusion contracts. Such problems arise in special, but not necessarily uncommon circumstances that will be described below. Our understanding of strategic behavior has been considerably extended by recent advances in game theory, and it will be the focus of this article.

I will begin by answering the Director-Levi question using an argument from basic price theory to show why exclusion will ordinarly fail to be profitable. I will then lay out three recent models of strategic exclusion: Krattenmaker & Salop (1986), Rasmusen, Ramseyer & Wiley (1989), and Aghion & Bolton (1987). Since these models use game theory, rather than more traditional price theory, the topic of exclusion provides a nice example of two styles of economic analysis.

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[7] See Rasmusen, Ramseyer & Wiley (1989), which explains the "Full Exploitation Argument" (related to arguments for tie-ins in Burstein (1960) for how exclusion might allow a protected first-period monopolist to fully exploit his existing monopoly power.

2. THE TRIANGLE-LOSS ARGUMENT: EXCLUSION FAILS

The first model addresses the Director-Levi question: Is the excluder willing to pay for exclusion?

Naked exclusion might conceivably be used to acquire either monopoly or monopsony power, and any model of exclusion can be adapted to either case:

(1) **Monopoly exclusion.** A seller induces buyers to sign contracts agreeing not to deal with any other seller. Example: If United Shoe requires shoemaking firms not to buy shoemaking machinery from any other company.

(2) **Monopsony exclusion.** A buyer induces sellers to sign conracts agreeing not to deal with any other buyer. Example: If Alcoa requires electric utilities not to sell to any other aluminum company.

To be consistent, I will use monopsony exclusion as the paradigm through all the models.

Consider an industry with two stages of production. First, suppliers of a raw material sell to intermediate firm at price *R*. The intermediate firms process the good at cost *C* per unit, and then resell to final consumers at price *P*. You might imagine that 100 farmers produce tomatoes in a given region and 10 grocery chains package and sell the tomatoes. Let us assume that all the input suppliers have identical upward-sloping supply curves of the kind shown in Figure 1.

We start by assuming that demand in the final market is perfectly elastic. The reason might be that packaged tomatoes can be brought in from outside at a certain price, which puts a ceiling on what a monopolist could charge. This assumption allows us to start by isolating the case of supplier-market monopsony; the next section will add final-market monopoly to the picture.

In competition with each other, the intermediate firms sell at a price of P_c in the final market. Hence, they bid up the input price to $R = P_c - C$. At this price a supplier's producer surplus equals area $A_1 + A_2 + A_3$ in Figure 1.

Let us suppose that one of the intermediate buyers, whom we will call the excluder, offers a bonux of X to any supplier who will sign a naked exclusion contract in which the supplier agrees to sell only to the excluder. If the supplier signs, the excluder becomes a monopsonist with respect to that supplier, and offer him the low monopsony price of $R_m < P_c - C$. The supplier's producer surplus then falls to A_1.

Table 1 illustrates the payoffs (not the prices) received by supplier *i* given the actions of all the other suppliers. Such a table is useful for testing whether an equilibrium exists in which all suppliers choose the same action. If the other suppliers refuse, will supplier *i* refuse too? If they sign, will he sign?

Table 1: Basic Model: No Exclusion

		All Other Suppliers	
		Refuse	Sign
Supplier *i*	Refuse	$A_1 + A_2 + A_3$	$A_1 + A_2 + A_3$
	Sign	$A_1 + X$	$A_1 + X$

Payoffs to Supplier i

Everything depends on the value of the signing bonus X. If the excluder offers a big enough X, exclusion succeeds. Krattenmaker & Salop (1986b) suggest this as their "Real Foreclosure" argument for exclusion. But one must answer the obvious question: how big does X have to be? If X equals $1 billion, the suppliers will sign and exclusion will succeed, but the excluder will suffer heavy losses. Failure to ask this question is what Director and Levi (1956) complained of: it is not enough to say that exclusion is possible; the question is whether it is profitble.

In the present case X must equal at least $A_2 + A_3$ for the supplier to be willing to sign, since his revenue falls by $A_2 + A_3$ in going from competition to monopsony. But the monopoly profit is only A_2, so the excluder is only willing to offer X up to A_2. Exclusion, while possible, is not profitable. Hence, unless one believes that firms purposely carry out unprofitable policies, fears of exclusion in this simplest case are groundless.

3.0 THE CARTEL RINGMASTER ARGUMENT

Although exclusion fails in the simplest monopsony model, changing the assumptions might change the conclusion. The previous model assumed that final demand was perfectly elastic. Instead, let us assume that the final demand curve is downward sloping, so successful exclusion results not just in monopsony in the input market, but also in monopoly in the final market. Thus, this model will mix vertical monopolization with horizontal monopolization. To keep down the level of complexity, let us also assume that the suppliers are infinitesimal, and that they form a continuum of length Q_c, all with the same production cost M, as shown in Figure 2. (Note that Figure 2 shows the entire market, unlike Figure 1, which showed just a single supplier.)

The excluder now obtains two benefits from exclusion: monopsony power in the input market (as in the previous example) *and* monopoly power in the final market. The previous section showed that monopsony power in the input market was not valuable enough to outweigh the cost of inducing suppliers to sign contracts. But what if the additional benefit of monopolizing the final market is added? Krattenmaker & Salop (1986a) suggest in their "Cartel Ringmaster" argument that exclusion will be profitable because the excluder gets the monopoly benefit from buying the rights to a supplier's raw materials, whereas the other intermediaries would only get the competitive benefit. But again we must ask how big X must be and whether the excluder would be willing to pay that much.

Table 2 shows the payoffs to supplier *i* per unit of raw material supplied. If all the suppliers refuse, so there is a fully competitive market, then the final-market price is P_c and the intermediaries bid the input price up to $R = P_c - C$. The supplier's cost of production is M, so his profit is $P_c - C - M$ per unit. If supplier *i* refuses, but all the other suppliers sign, then the excluder will raise the final-market price to the monopoly level P_m. A rival intermediary would then be willing to also charge P_m, and to pay supplier i $R = P_m - C$ per unit. Effectively, supplier *i* and the rival can undercut the ringmaster's cartel. Finally, is supplier *i* signs the exclusion contract, he receives the bonus X, but the excluder will pay him only $R = M$ for the raw material, so his total payoff is just X.

How big an exclusion bonus is the excluder willing to offer? For exclusion to succeed, supplier *i* must prefer the Sign-Sign payoff of X to the Refuse-Sign payoff of $P_m - C - M$, so it must be true that $X \geq P_m - C - M$. But the unit profit of the excluder from the combination of monopoly and monopsony is only $P_m - C - M$, since he obtains P_m from the consumer, pays C for processing, and pays M to the supplier. Moreover, the excluder must pay X to gain control of each of the Q_c units, but he receives the monopoly profit only on the monopoly output of Q_m, which must be smaller than Q_c to raise the monopoly price above the competitive price. Paying $X \geq P_c - C - M$ is therefore unprofitable, and exclusion is unprofitable in this model too.

Table 2: Cartel Ringmaster

		All Other Suppliers	
		Refuse	Sign
Supplier *i*	Refuse	$P_c - C - M$	$P_m - C - M$
	Sign	X	X

Payoffs per unit supplied to Supplier i.

The situation is very much like the standard cartel problem. If all the suppliers sign, then the excluder, acting as cartel ringmaster, can restrict output and increase industry profits. Some or all of those industry profits could go to the suppliers, so the suppliers might be better off if they all signed. But acting individually, each supplier prefers to stay out of the cartel and sell to the rival, who then undercuts the cartel ringmaster. The game is a form of the prisoner's dilemma: the suppliers would be willing to enter into a joint agreement to sign exclusion contracts, but individually each one prefers to refuse to sign.[8]

The cartel ringmaster method of cartelization would succeed if some way could be found around the hold-out problem. The cartel ringmasster method does not provide an answer to the problem of how to get suppliers to join the cartel, but if courts enforce the exclusion agreements, it does provide a mechanism by which to prevent cheating. Cartels usually face three big problems: getting everyone to join, deterring entry, and punishing those who join and then violate the cartel rules. The cartel ringmaster scheme does not help solve the first two problems, but it does solve the third, because no supplier who signs the agreement can flood the outside market. As Krattenmaker and Salop note, a seeming vertical restraint (the exclusion agreement) might actually be a horizontal restraint.

Returning to the details of the cartel ringmaster model, the discussion above established that exclusion does not occur in equilibrium, but not what actually does ocur. The equilibrium outcome is that exclusion contracts will be refused, but the strategies that lead to the outcome are complicated. For completeness, I will present the technical argument, which many readers may prefer to skip. Although the excluder will choose not to try to exclude in equilibrium, the strategies must specify what happens if he does try to exclude, which is where the complexity lies. The Nash equilibrium turns out to be the following strategy combination, which involves mixed strategies off the equilibrium path.

Excluder:	Offer $X \leq P_c - M - C$.
Each Supplier:	Do not sign if $X < P_c - M - C$. Sign with probability $\theta(X)$ if $X > P_c - M - C$.

The mixing probability $\theta(X)$ is chosen so that $P(Q_{final}) - C - M = X$, where Q_{final} is the amount sold in the final market, which depends on θ. The amount Q_{final} is the sum of the rivals' sales (which equal the total free supply, $(1 - \theta)Q_c$) and the excluder's sales (some amount less than θQ_c which is chosen by him as Stackelberg follower to maximize his profits).

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[8] For another statement of this argument, see Spulber (1989, p. 483).

To test whether this strategy is a Nash equilibrium, we must see whether any player has incentive to deviate. First, consider the suppliers. If a supplier signs, he receives $R = M$. If the free-market input price is $R = P_c - C$, as it would be under open competition, the supplier should sign if and only if $X > P_c - C - M$. But it will not be true that $R = P_c - C$ if some suppliers sign, because their signing allows the final-market price to rise above P_c, which also raises the free-market input price. The equilibrium strategy asserts that some suppliers sign and some refuse. For no supplier to wish to deviate, the suppliers must be indifferent between signing and refusing. The equilibrium final output price is $P(Q_{final})$. If the supplier signs, his payoff is X; if he does not sign, he can sell to some intermediary at a price of $R = P(Q_{final}) - C$ since the intermediary can resell for $P(Q_{final})$ in the final market. For the supplier to be indifferent between signing and not signing, it must therefore be true that the refuser's payoff of $P(Q_{final}) - C - M$ equals the signer's payoff of X. The percentage that sign, θ, is defined to make this true. Hence, no supplier can profit by deviating.

Second, consider the excluder. Can he profit by offering some $X > P_c - C - M$? Proportion $\theta(x)$ of the suppliers will sign, at a total cost of $\theta Q_c X$ to the excluder. Given the definition of θ, this amount equals $\theta Q_c(P(Q_{final}) - C - M)$. But the excluder's net revenue from the final market will be no greater than $\theta Q_c(P(Q_{final}) - C - M)$, because he must pay M to the suppliers and C for the processing. And in fact the excluder's net revenues from the final market are less than $\theta Q_c(P(Q_{final}) - C - M)$, because if $Q_{final} < Q_c$ it must be that the excluder does not sell the full amount he controls of the good. Hence, the net revenues from the final market cannot recoup the cost of the exclusion contracts.

This has been a complicated argument, so it is worth restating the point more simply. If input suppliers could collude, they could increase their profits by restricting industry output. Collusion is hard to enforce, but one way to make it easier to enforce is by somehow getting all suppliers to agree to sell to a single intermediary. The intermediary then restricts output to the ultimate consumers. The point is not especially to exclude rival intermediaries, but to cartelize the suppliers. If this works, the suppliers gain, unlike in true exclusion models. But the scheme suffers from a problem similar to that of any cartel: how is everyone brought into the scheme?

4.0 THE COORDINATION ARGUMENT

We come next to models in which exclusion is profitable and hurts the suppliers. In Rasmusen, Ramseyer & Wiley (1989), exclusion is a possible outcome, though not the only one. The model returns to the simple monopsony model of Figure 1, but with a crucial difference. Instead of the processing cost C being independent of the total amount processed, let us assume that there is a minimum efficient scale for processing. More specifically, let us assume that an intermediary's average processing cost $C(Q)$ is such that $C' < 0$ *for* $Q < Q^*$ and $C(Q) = C$ for $Q \geq Q^*$. Average cost falls until output reaches the minimum efficient scale of Q^* and is constant thereafter, as illustrated in Figure 3. Let us also assume that Q^* is greater than the output any single supplier could supply to an intermediary.

The supplier payoffs associated with different strategy combinations are shown in Table 3. If all the suppliers refuse, then supplier *i*'s payoff is simply the competitive producer surplus, $A_1 + A_2 + A_3$. If supplier *i* signs, whether or not the other suppliers sign, *i*'s payoff is the A_1 he gets from his monopsony sale plus the signing bonus of X.

The strategy combination crucial to the argument is for supplier *i* to refuse, but the other suppliers to sign. In that case, unlike in the original model, the rival intermediary will choose not to enter. If he did enter, buying just from supplier *i*, his output would be much less than Q^* and his average processing cost $C(Q)$ would be too high to compete with the excluder in the final market. But if the rival stays out, the refusing supplier *i* not only misses the signing bonus X, he also faces a monopsony buyer, so his payoff is just A_1.

For low values of X, including $X = 0$ this game has two Nash equilibrium outcomes: (a) all suppliers sign, and (b) no suppliers sign. Looking at Table 2, note that if all the other suppliers sign, so will *i*; but if all the other suppliers refuse, so will *i*. This is a coordination game, similar to "Pure Coordination" in Chapter 1 of my 1989 book. Which of the two different equilibria is actually played out depends on a number of considerations detailed in Rasmusen, Ramseyer & Wiley (1989) and Rasmusen (1989b). Profitable exclusion is open as one possibility, especially since the excluder may be able to influence the expectations and beliefs of the disorganized suppliers.

The Coordination Argument shows a way around the Director-Levy (1956) point that exclusion is costly. In equilibrium, $X = 0$, but suppliers sign the contract anyway. The reason is that no supplier's signature hurts him individually; rather, it is the suppliers' signing in aggregate that causes harm.

Table 3: Coordination

		All Other Suppliers	
		Refuse	**Sign**
Supplier *i*	**Refuse**	$A_1 + A_2 + A_3$	A_1
	Sign	$A_1 + X$	$A_1 + X$

Payoffs to Supplier i.

5.0 LIQUIDATED DAMAGES AND CONDITIONAL CONTRACTS: EXCLUSION SUCCEEDS

Aghion & Bolton (1987) contains two models of exclusion, one based on liquidated damages and other on conditional exclusion contracts. I will simplify these models drastically from their original form and use a numerical example. Also, I will recast the models as monopsony rather than monopoly, to be consistent with our analysis so far. The reader should be warned that it is not clear whether Aghion and Bolton wold approve of my simplification of their more intricate model.[9]

In both models, 10 suppliers can each produce one unit of the input at a cost of $M = 1$. Demand in the final market is assumed to be elastic at price $P = 3$, to avoid the monopoly-monopsony complexities discussed earlier in the Cartel Ringmaster model. Initially there is one intermediary buyer, who processes the input and sells it in the final market. This initial intermediary, called the incumbent, can process one unit at cost $C_{incumbent} = 0.5$. A rival intermediary, who appears later, can process one unit at the lower cost $C_{rival} = 0.1$. If there is no exclusion, the rival enters the market, outbids the incumbent for the input, and buys the entire 10 units at a price of $R = 2.5$. The rival's profits are 4 $(=(10)(3 - 2.5 - 0.1))$, the incumbent's profits are 0, and the sum of the suppliers' profits is 15 $(=(10)(2.5 - 1))$.

5.1 Aghion & Bolton I: Liquidated Damages

The first model views exclusion as a conspiracy between the incumbent and the suppliers to extract profits from the entrant. This is possible because the low processing costs of the rival would ordinarily allow him to make a profit in competition with the incumbent.

The most obvious possibility for collusion is between the incumbent and the rival, who could cooperate to set the input price at the monopsony level of $R + 1$ and divide the supplier's former profits of 15 among themselves. But we will assume that the incumbent and rival do not collude in this way (which, in any case, would fail if there were other intermediaries that could also process at cost $C = 0.5$). Instead, we will see that the incumbent and the *suppliers* can collude to take away the rival's profits.

The method of collusion is a liquidated-damages contract. Suppose the contract specifies liquidated damages of 0.4 if a supplier switches to the rival. The rival would still enter, but in competition with the incumbent's $R + 2.5$ he must offer $R = 2.9$ to attract the suppliers instead of $R = 2.5$. The rival's profit will be 0 (=(10)(3 = 2.9 - 0.1)), the incumbent's profit will be 4 (=(10)(.4)), and each supplier will have a profit of 1.5 (=91)(2.9 - 0.4 - 1)). The suppliers do no worse than under simple competition, and they would do better if th excluder offered them some positive X to sign the liquidated-damages contract. The excluder does very well, though only by going out of business and profiting from the liquidated damages.

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[9] Besides using monopsony, the chief difference between this model and Aghion & Bolton's (1987) original is in the entrant's processing cost. They assume that ex ante nobody knows C_{rival}, which takes values between 0 and 1 with uniform probability. This means that even without any exclusionary conduct on the part of the incumbent, the entrant would sometimes not enter. The present model rules out this possibility of innocuous exclusion.

Exclusion could happen as a result of liquidated-damages contracts, but only accidentally, and in a slightly more complicated world. In the original Aghion & Bolton model no one knows in advance what the rival's costs will be. Suppose that there is a 0.9 chance of the rival having costs $C_{rival} = 0.1$, and a 0.1 chance of $C_{rival} = 0.4$. Ten percent of the time the damages of 0.4 will exclude entry. But this is accidental, and the incumbent wil regret the absence of the liquidated damages. This exclusion contract is profitable only when it fails to prevent entry. Moreover, the incumbent must pay $X = 0.15$ to induce suppliers to sign this contract, because with probability 0.1 they will receive a payment of only $R = 1$ instead of $R = 2.5$.

The chief limitation on Aghion & Bolton I is that it assumes there is a good chance the potential entrant will have lower costs than the incumbent, which seems unlikely.

Mathewson & Winter (1987) have also constructed a model in which the two parties to the exclusion contract benefit at the expense of an outside party. In their model, two sellers, one of which has lower costs than the other, sell differentiated products to a monopsony buyer. Under unfettered Bertrand competition, both sellers would make positive profits. If the low-cost one offers an exclusive-dealing contract, however, he can do better. He can effectively commit to a lower price, and the buyer and that seller end up with higher profits, at the expense of the high-cost seller.

5.2 Aghion & Bolton II: Conditional Offers

In Aghion & Bolton's (1987) second model the rival must incur an entry cost of $F = 1$, which presumably was paid some time in the past by the incumbent. This means that the market is a natural monopoly: average cost declines with output.

If the rival enters and captures the entire market as before, the input price is the same $R = 2.5$, and the entrant's profit equals 3 (=(10)(3 - 2.5 - 0.1) -1).

In this model the exclusion contract does not specify liquidated damages; it is just a naked exclusion contract that says the supplier cannot serve anyone but the incumbent. The contract is different in another way, however: it is a conditional contract that allows the incumbent to commit to his future input prices. Specifically, suppose the exclusion contract specifies that the supplier receives $R = 5$ if the other suppliers refuse to sign, and $R = 1.1$ if they do sign.

The payoffs from different combinations of actions are shown in Table 4. If all the suppliers refuse, the rival enters, R equals 2.5, and after paying the production cost of $M = 1$ each supplier has a payoff of 1.5. If the suppliers all sign, then the rival stays out, R equals 1.1, ,and each supplier obtains a payoff of 0.1. If supplier i signs but the other suppliers refuse, then the contract specifies a price of $R = 5$ for supplier i, and his payoff is 4 after paying the production cost.

The only nonstraightforward payoff is the 0 that supplier i obtains when he refuses to sign, but the other 9 suppliers do sign. The rival will not enter if he can only buy from a single supplier, because his profit from entering, buying from that one suppoier, and reselling in competition with the incumbent would be -0.6 (=1(1)(3 - 2.5 - 0.1) -1). So the rival will not enter. But in that case the incumbent has monopsony power over the lone refuser, and can pay him just $R = 1$, which yields a supplier payoff of 0.

The game is like a 10-person prisoner's dilemma. Signing is a dominant strategy for supplier i. If the other suppliers refuse, i's payoff is 4 from signing and 1.5 from refusing. If the other suppliers sign, i's payoff is 0.1 from signing and 0 from refusing. So supplier i will sign. But every other suppliers will sign too, each will obtain a payoff of 0.1, and exclusion will be successful. And, in fact, the excluder need not offer them even as high a price as $R = 1.1$. A price of $R = 1.001$ would maintain signing as the dominant strategy.

Table 4: Conditional Offers

		All Other Suppliers	
		Refuse	Sign
Supplier i	Refuse	1.5	0
	Sign	4	0.1

Payoffs to Supplier i.

Several elements of this model drive the outcome of exclusion, and not all of them are necessary. Unlike in Aghion & Bolton I, it does not matter that the rival has a cost advantage. If the two firms have the same processing cost of $C = 0.5$, however, the natural monopoly feature of the market results in exclusion without any exclusion contracts; it would not be profitable for the rival to enter and rive the price of inputs up to $R = 2.5$, an input price which yields no surplus to pay the fixed cost of entry. On the other hand, conditional offers without any cost advantage are sufficient by themselves to exclude the rival if there is either a fixed cost, or, as in Rasmusen, Ramseyer & Wiley (1989), a minimum efficient scale. Making the offers conditional turns that model from a coordination game into a prisoner's dilemma. Suppliers sign because they are not bound to sell to the excluder unless the rival fails to enter, but the rival will not enter because he cannot reach the minimum efficient scale when all the suppliers sign.

6.0 CONCLUSIONS AND CAVEATS

Of the three categories of reasons for exclusion - efficiency, strategic, and price discrimination - only strategic reasons have been discussed in this paper. Since exclusion for efficiency reasons is something that government policy should encourage rather than discourage, it is worth at least giving the flavor of possible efficiency reasons. Ornstein (1989) surveys these and lists the motivations. Some examples are:

(1) If a supplier produces a good of uneven quality and sells it to two different buyers, then if one buyer inspects the good, the other buyer must inspect it too, or end up with all the low-quality items. Insisting that the supplier sell only to one seller avoids this inspection cost.[10]

(2) The buyer might wish to provide the supplier with capital, technical expertise, or management advice. If the supplier sells to other buyers, they free-ride on those aids.

(3) It may be efficient for the buyer to have a club with which to hit the supplier in case of supplier misconduct. The supplier might, for example, be tempted to produce a low-quality good. If the buyer can threaten to withdraw his custom and leave the supplier without demand, the buyer can ensure high quality. Allowing the supplier to sell to other buyers diminishes the force of this threat.

The government must also be careful not to confuse naked exclusion with other behavior. A contract requiring the buyer to buy all of a seller's output, for example, is very different from a contract requiring the seller to sell only to one buyer, and is also more common. But none of the reasoning in this article applies to requirements that the buyer buy all of a seller's output.

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[10] Kenney & Klein (1983) have made a similar argument with respect to sales contracts in the diamond market.

Other kinds of actions have also been mistakenly thought to be exclusionary; an example with which I am familiar is the government accusation in the 1953 United Shoe case that the leasing of shoe machinery was intrinsically exclusionary (see Wiley, Rasmusen & Ramseyer, 1989).

What conclusions can be drawn for the policymaker from all this theory? It would be dangerous to conclude too much yet, since the theory is stil not fully understood. But the analyst can give some advice to a policymaker who must act without full knowledge. First, we cannot say categorically that antitrust law ought not to worry about exclusion. The Triangle-Loss Argument does tell us that exclusion will not be as general a problem as price-fixing. But the Coordination Argument and the Aghion-Bolton models show that exclusion can be a danger, and the Cartel Ringmaster Argument shows that it can facilitate horizontal collusion. The government should act conservatively, but it should act as a check on egregious exclusion when the excluder cannot present any efficiency justification for his actions.

The various models give some guide to the circumstances in which exclusion might be a danger. The Coordination Model requires the excluder to sign up enough suppliers that no rival can attain the mimimum efficient scale. Thus, if some buyer signs up only a small number of suppliers, the Coordination Argument cannot be used to attack his actions. If, on the other hand, the excluder faces a threat of entry, signs up virtually all the suppliers, and then actually buys inputs from only a fraction of the controlled suppliers, the government should take notice.

The Cartel Ringmaster Argument fails to explain why the suppliers should sign up with the ringmaster rather than hold out and sell separately to a rival. But if the suppliers can be induced to all sign up, which is in their joint interest, the exclusion contract does provide a means to prevent members of what is effectively a cartel from cheating. This has implications similar to the Coordination Argument: if the excluder signs up all the suppliers and then contracts the industry's output, the conclusion of monopolization is hard to avoid. The difference is that in the Cartel Ringmaster Argument the focus is on monopolization of the final market.

Aghion and Bolton's (1987) arguments point towards more specific features of exclusion contracts. Their first model suggests that the liquidated damages specified by a contract should not be significantly greater than the harm caused by a supplier's switch to another buyer. Whether that harm can be measured well enough for this to be the basis for a legal rule is a hard question. But liquidated damages for the purpose of extracting profits from a more efficient entrant have the potential to seriously lower efficiency. The damages themselves are just a transfer, and as discussed above, the excluder has higher profits the less entry he deters. But the situation that fits this model best is the one in which some rival intermediary does research to develop a new technology with lower cost. The liquidated damages would allow the incumbent to seize the benefits from the new technology, discouraging research. If, for example, any firm that develops a new computer finds that it must pay a high price to chip makers to induce them to switch from their old buyer, fewer new computers will be developed.

The second Aghion and Bolton (1987) argument provides perhaps the easiest guide to policy. That argument points out that a conditional contract, which binds the supplier only if other suppliers sign the contract, can lead to inefficient exclusion. The remedy would be to refuse to enforce such conditional contracts.

It is interesting to compare the warnings of these models to the U.S. Department of Justice's *1985 Guideines for Vertical Restraints*. These state that there is a worry that exclusive dealing may exclude rivals by "prohibitively raising their cost of a vital input or their cost of distribution," but that this is likely to be a danger only if three conditions are met. The three conditions are that "(1) The 'nonforeclosed market' is concentrated and leading firms in the market use the restraint; (2) The firms subject to the restraint control a large share of the 'foreclosed' market; and (3) Entry into the foreclosed market is difficult." These are preconditions for all the models that have been discussed; exclusion cannot have harmful effects unless it is possible to lock up much of the foreclose market without fear of entry there.

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Figure 1: Monopsony (individual supply curve)

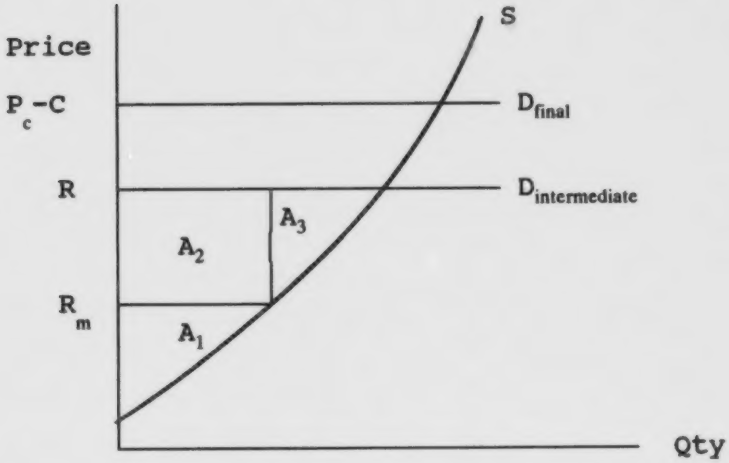

Price
P_c-C
R
R_m
S
D_{final}
$D_{intermediate}$
A_1
A_2
A_3
Qty

Figure 2: Monopsony and Monopoly

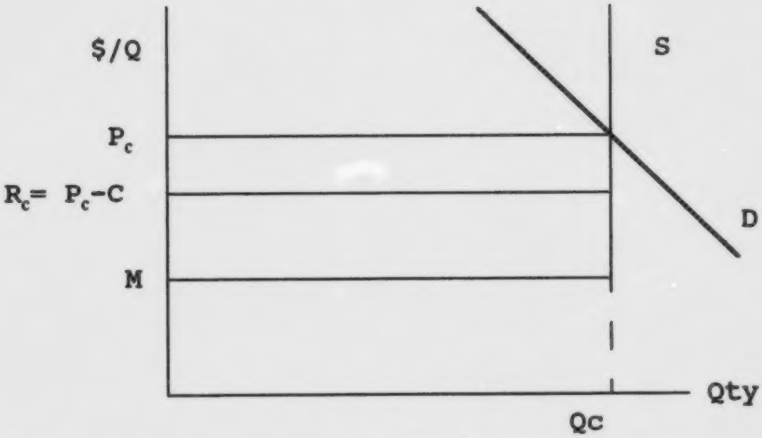
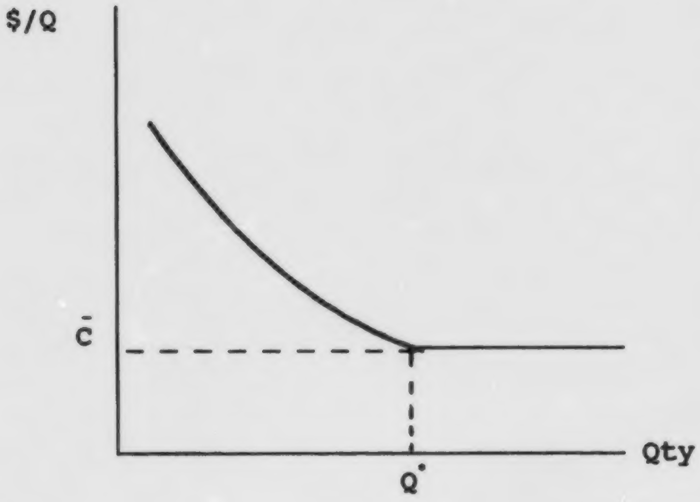

$/Q
P_c
R_c= P_c-C
M
S
D
Qty
Qc

Figure 3: The Cost Curves with a Minimum Efficient Scale



Chapter 17

DECEPTIVE MARKETING PRACTICES

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1.0 INTRODUCTION

A broad spectrum of deceptive marketing practices are dealt with in sections 52 to 61 of the *Competition Act*.

Before dealing with the specifics of the law relating to deceptive marketing practices, it is important as a matter of background information to briefly consider the matter of jurisdiction. Historically, and as recently stated in *R. v. Shaklee Canada Inc.*,[1] anti-combines legislation has been upheld as validly enacted federal legislation by virtue of subsection 91 (27) of the *Constitution Act*, 1867, the Criminal Law power. Peace Order and Good Government has also been referred to, as has the Trade and Commerce power.

In *General Motors of Canada Ltd. v. City National Leasing*,[2] the Supreme Court of Canada in April 1989 held that the *Combines Investigation Act* was *intra vires* Parliament by virtue of the Trade and Commerce Power and that s. 36 in particular was also within federal jurisdiction. The related Supreme Court of Canada decision, *Quebec Ready Mix Inc. v. Rocois Construction Inc.*,[3] was to the same effect. The matter of federal jurisdiction over this type of legislation now appears settled.

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[1] [1985] 1 F.C. 593, 4 C.P.R. (3d) 433 (C.A.), affd [1988] 1 S.C.R. 662, 84 N.R. 385.

[2] (1986), 28 D.L.R. (4th) (Ont. C.A.), affd [1989] 1 S.C.R. 641.

[3] (1985), 25 D.L.R. (4th) 373, 64 N.R. 209 (F.C.A.) affd [1989] 1 S.C.R. 695.

2.0 MISLEADING ADVERTISING (S. 52)

Misleading advertising constitutes the most common offense under the *Competition Act* (see Tables 1, 2) and will probably continue to be so in the future. Section 52(l)(a) forbids a person from making "a representation to the public that is false or misleading in a material respect" when such representation involves the promotion of the supply or use of a product, or for the promotion of a business interest. In its earliest form this offense was false advertising "knowingly made" to enhance the price of real and personal property. Amendments led to the in inclusion of "deceptive or misleading" advertising of "business or commercial" interest and eventually "knowingly" was dropped from the provision altogether. The offense covers any direct or indirect promotion of any business interest by any means. For instance in *R. v. Park Realty Ltd.*,[4] a representation on a multiple listing card describing a home was deemed to be a representation to the public because Section 52 (l)(a) includes indirect promotion. Although not a direct advertisement to the public, the multiple listing card was an indirect promotion through the means of advising agents who in turn indirectly promote the property to members of the public.

2.1 "Material"

Whether or not an advertisement is misleading is solely a question of law: *Alberta Giftware Ltd. v. The Queen.*[5] The advertising will be misleading only where it is misleading in a material respect. In *R. v. Patton's Place Ltd.*, it was stated that "...the word 'material' used here must bear its normal meaning and that is, it is a representation which is calculated to, and in effect does, lead a person to a certain course of conduct because he believes the information put before him indicates that this would be advantageous to himself." The Shorter Oxford Dictionary's meaning "of much consequence, or important, or pertinent, or germane or essential to the matter" has also been referred to: *R. v. Tege Investments Ltd.*.[6]

Trivial or inconsequential statements that would not objectively influence anyone would not constitute an offense. A blatant example of advertising that was not "unconsequential or trivial' is found in *R. v. Parkland Village Heights Ltd.*[7] In that case the defendant advertised single family homes starting at a price of $24,900, but the advertisement did not inform readers that the price of the land was not included and would have to be separately purchased or rented. The defendant was found guilty and fined $1000 dollars. Alternatively, in the case of *R. v. Rust-Oleum Canada Ltd.*,[8] the words "stops rust" on the accused's cans of primers and paints were not shown beyond a reasonable doubt to be false or misleading. Although the experts agreed that the protective coatings eventually broke down and rust did occur from a low of eight years to a high of thirty years, the average purchaser would not expect that a protective coating would last forever. Since the accused did not make such a claim he was acquitted.

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[4] (1978) 43 C.P.R. (2d) 29, 2 C.R. (3d) 336 (Man. Prov. Ct).

[5] [1974] S.C.R. 584, 11 C.P.R. (2d) 233, 3 D.L.R. (3d) 321, affg. 6 C.P.R. (2d) 10, 7 C.C.C. (2d) 203, [1972] 4 W.W.R. 696 (Alta. C.A.).

[6] (1978), 51 C.P.R. (2d) 216 (Alta. Prov. Ct.).

[7] (1977), 37 C.P.R. (2d) 56 (Alta. Prov. Ct.).

2.2 Test for Impression on the Audience

A common theme in the jurisprudence is the issue of the audience and what test is to govern the impression on the audience. In deciding whether or not the advertising contains a representation which is untrue or misleading, the courts have referred to "the average person to whom the advertisement is directed" and to "that vast multitude which includes the ignorant, the unthinking and the credulous" who do not stop to analyze an advertisement but are often governed by appearances and general impressions. For example in *R. v. Imperial Tobacco Products Limited*,[9] where the accused was convicted for an untrue statement in its cigarette advertisement to the effect that there was "$5.00 in every pack of new Casino". The packages did not contain $5.00, but only a chance to win. A nominal fine of $2,500 was imposed on the first count and a fine of $500 imposed on the second. This standard has been diminished somewhat in subsequent decisions. For example, in *R. v. T. Eaton Company Limited*,[10] the readers of an advertisement were assumed to have had some common sense, while in *R. v. International Vacations Limited*,[11] those considering an advertisement for European air flights were assumed to be literate, intelligent and careful readers.

The focus of the courts is on the ultimate impression made on the minds of readers of the statement, having regard to what is actually said and what can reasonably be implied. In applying the chosen standard, the court is enjoined to consider the general impression conveyed by a representation as well as the literal meaning conveyed by the particular wording of the advertisement. For instance in *R. v. K-Mart Canada Limited*,[12] the accused advertised a free roll of film to those leaving film for processing. The cost of the new film was however included in the processing price. The court found the representation to be false or misleading. The general impression was that the price of the film was not included in the cost of processing which was untrue. In *R. v. Canadian Tire Corporation Limited*,[13] the defendant in its catalogue and in a newspaper advertisement represented that the valves, springs and push rods in its remanufactured engines were new. In fact they were not new but reconditioned. In convicting the accused the court found that looking at the advertisement as a whole with the emphasis upon the word "new" repeated many times indicated that "new" was indeed the impression that was intended to be conveyed.

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[8] (1978), 42 C.P.R. (2d) 193 (Ont. Prov. Ct.).

[9] (1971), 3 C.P.R. (2d) 178, 22 D.L.R. (3d) 51, 4 C.C.C. (2d) 423 (Alta. S.C. App. Div.), affg 64 C.P.R. 3, 16 D.L.R. (3d) 470, 2 C.C.C. (2d) 533 (S.C.).

[10] (1975), 26 C.P.R. (2d) 118 (Alta. S.C.).

[11] (1980), 56 C.P.R. (2d) 251, 124 D.L.R. (3d) 319 (Ont. C.A.).

[12] (1978), 50 C.P.R. (2d) 271 (N.S. Co. Ct.).

While the Crown does have to convince the Court that the representation is misleading, it is settled that in proving its case the prosecution does not have to establish that a member of the public has actually been mislead by the advertisement: *R. v. McKay*;[14] *R. v. Imperial Tobacco Products Limited*;[15] *R. v. Alexanian & Sons Limited*.[16] As was stated by the court in *R. v. Simpson Limited*,[17]

> "to prove the offence it is not necessary for the Crown to prove that the purpose of the representation was achieved. The offence is committed at the point when the materially false or misleading representation is made to the public, whatever may have been in fact the consequential result of the misrepresentation" (p. 8). This would seem to be the case even where a member of the public has a misleading aspect of an advertisement explained to him so as to remove the potential deception, and where the misleading statement is openly contradicted by some other piece of visible information. The question is whether, on the objective standard described earlier the statement is misleading.

2.3 Third Party Liability

Virtually any representation comes within Section 52. Various third parties such as employees, advertising agencies, manufacturers and franchisees have all been held to be liable. In *R. v. K-Mart Canada Limited*,[18] the defendant's advertising flier included a statement of its policy to provide rain checks for any unavailable advertised item. When a customer attempted to purchase an unavailable item he was told by the employee of the defendant that "rain checks" were not provided for items once they were sold out. Defense evidence established that the defendant had a policy of providing rain checks and this was brought to the attention of its employees through the company manual as well as being discussed at staff meetings. The court held that failure of its servants to follow the stated policy rendered the accused vicariously liable under Section 69 of the Act. Despite, the policy, the defendant had not established that it took reasonable precautions and exercised due diligence pursuant to Section 60(2) to prevent the occurrence of the error. Further, the defendant did not take reasonable measures to bring the error to the attention of the complainant consumer as required by Section 60(2)(c).

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[13] (1986), 14 C.P.R. (3d) 372 (Man. Prov. Ct.).

[14] (1979), 35 N.S.R. (2d) 553 (S.C. App. Div.), affg (unreported, February 19, 1979, N.S. Co. Ct.).

[15] *Supra*, note 9.

[16] (1974), 22 C.P.R. (2d) 37, 23 C.C.C. (2d) 249, 17 N.R. 43 (Ont. C.A.), affd [1976] 2 S.C.R. v, 33 C.P.R. (2d) 144, C.C.C. loc. cit.

[17] Unreported, Ont. D.C., Oct. 18, 1988.

[18] Unreported, May 13, 1983 N.S. Mag. Ct..

One must also remember that an individual can be convicted at the same time as his corporate employer where the charges against both relate to the same facts: *R. v. Fell*.[19]

2.4 Intent

It is not necessary for the Crown to prove that the advertiser intended to mislead: misleading advertising is a strict liability offense in the sense in which that classification is used by the Supreme Court in *R. v. Sault Ste. Marie*. See for example: *R. v. Parkside Ford Sales Limited*;[20] *R. v. Garibaldi Lifts Limited*;[21] *R. v. Giftwares Wholesale Company*.[22]

Section 60(2) provides a defense of due diligence for the accused. An offender may use variations of the defense of reasonable behaviour to meet the charge. If the person charged can establish that the offending representation was the result of an error, and that reasonable efforts have been made to avoid such errors, he may have a successful defense. However it would appear that the courts are not easily persuaded that the offender has exercised due diligence and taken reasonable precautions to prevent errors occurring, especially when he purports to rely upon his own lack of expertise, a reputation for reliability or the expertise of his supplier. See for example *R. v. Les Distributeurs Cardinal Ltee*.[23] The view has been expressed judicially that Parliament intended to place the responsibility for the advertisement on the person who may benefit from the inducement created by the advertisement.

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[19] (1981), 59 C.P.R. (2d) 34, 131 D.L.R. (3d) 105, 64 C.C.C. (2d) 456 (Ont. C.A.).

[20] (1979), 45 C.P.R. (2d) 149, [1979] 3 W.W.R. 367, 6 B.L.R. 183 (Man. Co. Ct.).

[21] (1977), 33 C.P.R. (2d) 8, 35 C.C.C. (2d) 190, [1977] 3 W.W.R. 350 (B.C. Co. Ct.).

[22] (1977), 32 C.P.R. (2d) 243, 36 C.C.C. (2d) 330, [1977] 4 W.W.R. 326 (Man. Co. Ct.).

[23] (1979), 55 C.P.R. (2d) 155 (Que. Sess. Peace).

2.5 Constitutionality

Section 60(2) has recently been held to be contrary to Section 7 of the 1982 *Charter of Rights and Freedoms* which guarantees the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice. In *R. v. Giftwares Wholesale Company Limited*,[24] the Manitoba Provincial Court held that Section 37.3(2), now section 60(2) of the new Act, violated the presumption of innocence guaranteed by Section 11(d) of the *Charter* in that the accused is compelled to prove he is not guilty of the offense. The court stated that the accused is placed in an unfair and unreasonable position in not being notified prior to the laying of charges of the alleged false or misleading advertising and thus being unable to comply with the elements set out in Section 60(2) (formerly 37.3(2)) and in particular with paragraphs (c) and (d) of the Section. The court held therefore that Section 60(2) contravened Sections 7 and 11(d) of the *Charter* and that the subsection was of no force and effect.

A similar development occurred in the case of *R. v. Westfair Foods Limited*[25] in the Saskatchewan Court of Queen's Bench, where as part of a price comparison advertisement the accused indicated certain goods which it sold were not available from a competitor. The goods were in fact available but an employee for the accused had checked on two occasions with the competitor and had been told the items were out of stock. While the court found that the accused had met the common law test for due diligence but did not satisfy the requirements of Section 62(2) (c) and (d). In order to satisfy these provisions, the accused would have had to admit the *actus reas* and if the accused honestly believed that there was no *actus reas* and did not for that reason comply with the notice requirements, then no defense would be available and the offense would become one of absolute liability. In effect, although meeting the common law test for due diligence, Section 60 would deprive an accused of that defense and an offense under Section 52(1) would be in effect one of absolute liability. Having regard to the potentially severe penalty this was held to be contrary to Section 7 of the *Charter*.

But all is not clear on the constitutionality issue. Section 60(2) has also been held to be constitutionally valid in some instances. In *R. v. Independent Order of Foresters No. 1*,[26] it was held that although Section 52(1) in conjunction with Section 60(2) places the accused in the position of having to choose between two positions open to it, this did not offend the *Charter*. The accused must either challenge the Crown's proof of the *actus reas* or admit the *actus reas* and claim the due diligence defense under Section 60(2). One can easily appreciate the dilemma facing an accused. The Foresters case also held that Parliament did not lack the constitutional jurisdiction to create the offense in Section 52(1) in the words that it had used, or to restrict the statutory defense in Section 60 in the way that it had.

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[24] *Supra* note 22.

[25] (1985), 5 C.P.R. (3d) 373, 16 D.L.R. (4th) 668, 18 C.C.C. (3d) 178, (Q.B.).

[26] (1986), 13 C.P.R. (3d) 563 (Ont. Dist. Ct.).

In *R. v. The Wholesale Travel Group Inc*,[27] the accused was charged with five counts of making false or misleading representations to the public regarding the sale of vacation travel packages. A provincial court judge held that Sections 52(1)(a) and 60(2) were unconstitutional as offending Sections 7 and 11(d) of the *Charter*. In allowing the Crown's appeal the Ontario High Court of Justice also held that these Sections did not offend Section 11(d) of the *Charter*. In November 1989 the Ontario Court of Appeal (Tarnopolsky, J.A.) held that S.37.3(2)(c) and (d) [now 60(2)(c) and (d)] are contrary to S.7 of the *Charter* and are of no force and effect.[28] It further concluded that the provisions could not be saved by S.1 of the *Charter*. The Court also held that S.37.3(2)(a) and (b) violated S.11(d) of the *Charter* and S.1 would not alter this result. Finally, the Court of Appeal held that "although S.36(1)(a) [now S.52] is constitutional, as are the defences set out in paras 37.3(2)(a) and (b), the accused would not have the onus of 'establishing' them." The Crown appealed the case to the Supreme Court of Canada.

2.6 Adequate and Proper Test

Turning now to Section 52(1)(b), one may not make a representation to the public in the form of a statement, warranty or guarantee of the performance, efficacy or length of life of a product, unless such representation is based on an adequate and proper test. Again this is an offense of strict liability and *mens rea* need not be established: *R. v. Gregory*.[29] The section requires an accused to lead evidence in support of tests and then it is open to the crown to lead evidence to show such testing was not adequate and proper. The section, therefore, casts an onus on the accused to make adequate and proper tests on the product before any representation is made. This procedure was set out in the case of *R. v. Batt*,[30] where there was no evidence of any tests whatsoever. It was also held that evidence of numerous defense witnesses indicating complete satisfaction with the product cannot cure the failure to prove the representations were based on adequate tests conducted prior to the presentation being made to the public.

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[27] (1988), 5 W.C.B. (2d) 285 (Ont. H.C.J.).

[28] See *Canadian Competition Policy Record*, Vol. 11(1), 1990, pp. 8-10.

[29] (1973), 11 C.P.R. (2d) 32, 12 C.C.C. (2d) 137 (Que. Sess. Peace).

[30] (1980), 53 C.P.R. (2d) 152 (B.C. Prov. Ct.).

In *R. v. Alpine Plant Foods Limited*,[31] it was held that Section 52(1)(b), formerly 36(1)(b), is a separate and distinct offense from paragraph (a) and as long as a performance claim set out in an advertisement does not suggest that it is based on adequate and scientific standards, then paragraph (a) is not contravened even though paragraph (b) may be contravened.

While it appears that testing need not meet the standards of published research papers, it should be conducted to show that the result claimed is not a mere chance or a one time result and is in accordance with accepted industry testing standards. There should be some replication in closely supervised testing. Testing should be done over a number of years in differing conditions. The reporting of statistics can be expected to be relied upon by consumers and therefore must be substantiated: *R. v. Alpine Plant Foods Limited*.[32]

Section 52(1)(b) has also been subject to challenges under the *Charter*. In *R. v. Canadian Tire Corp*,[33] it was found by the Ontario Provincial Court that Section 52(1)(b) as well as Section 52(2) and Section 60(2) did not breach the reverse onus provisions of the *Charter*. In *R. v. Teixeira*,[34] it was also held that the reverse onus in Section 36(1)(b) was not constitutionally invalid. The reverse onus provision was reasonable having regard to the magnitude of the problem of misleading advertising and the duty to protect all citizens. In *R. v. Big Mac Investment Limited*,[35] the accused was charged under the former Section 36(1)(b) in relation to representations not based on adequate and proper tests in relation to a weight loss machine. The accused challenged the validity of the section on the basis that it offends Sections 7 and 11(d) of the *Charter*. The *Charter* challenge was dismissed and the accused was acquitted on the evidence.

In *R. v. Kassabian*,[36] the accused appealed a conviction for making a representation as to performance not based on adequate and proper tests. The accused challenged Section 36(1)(b) as contravening Section 11(d) of the *Charter* as it imposes a reverse onus on the accused to prove that any testing underlying the performance claim was adequate and proper. The Ontario District Court agreed that Section 36(1)(b) of the *Combines Investigation Act* violated Section 11(d) of the *Charter*. The Court relied on *R. v. Oakes*, where it was stated that there is no justification for allowing the use of a reverse onus provision relieving the Crown from calling any probative evidence to establish an essential element of the case. The Court found that Section 36(1)(b) shifted both the evidentiary and legal burden. The presumption of innocence in Section 11(d) of the *Charter*, given the consequences of being found to be criminal, is crucial. For a reverse onus provision to be valid, there must be a rational connection between the proved fact and the presumed fact. In examining the reasonableness of the provision, consideration must be given to: the magnitude of the evil to be suppressed as measured by the gravity of harm resulting therefrom; the difficulty for the prosecution of proving the presumed fact; and, the relative ease with which the accused may prove or disprove the presumed fact. A provision requiring an accused to disprove, on a balance of probabilities, the existence of a presumed fact which is an important element of the offense violates section 11(d) of the *Charter*. A party seeking to uphold a limitation on a *Charter* right as reasonable must do so on a preponderance of probability. In this case, it was held there was no rational connection between the onus on the accused to prove adequate and proper tests and the objective of protecting society from the ills associated with promoting a business interest by making a representation to the public in the form of a statement, warranty or guarantee of performance which is not based on adequate and proper tests. The onus on the accused took away the burden that rests upon the Crown and is out of proportion to the ill it purports to curtail. Therefore, Section 36(1)(b) was found to be of no force and effect.

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[31] Unreported, October 29, 1980 Ont. Prov. Ct..

[32] *Ibid.*

[33] Unreported, April 16, 1985 Ont. Prov. Ct.

[34] (1986), 12 C.P.R. (3d) 263 (Que. Sess. Peace).

[35] Unreported, December 8, 1987, Man. Prov. Ct.

[36] Unreported, June 7, 1988, Ont. Dist. Ct.

Section 52(1)(c) deals with representations to the public with respect to warranties or guaranties of a product, as well as the replacement, maintaining or repair of articles or parts thereof. If such purported warranty, guaranty or promise is materially misleading or if there is no reasonable prospect that it will be carried out, the author of the representation will has contravened the Act.

2.7 Misleading Price Advertising

Section 52(1)(d) forbids a person from making a materially misleading representation to the public concerning the price at which a product or like-products have been, are or will be ordinarily sold. In *R. v. Allied Towers Merchants Ltd.*,[37] the Court ruled that there was nothing in the expressed language of Section 33C(1) of the Act disclosing any intention that *mens rea* is not an essential ingredient of the offence. However, it was held that such an intention was derived by necessary implication from Section 33C(2). If it were necessary in order to prove the offence to establish that the accused knew that the representation he made was in fact materially misleading, a publisher who accepted an advertisement in good faith for publication in the ordinary course of business would not require the special defence provided in subsection (2). The Court therefore concluded that Section 33C(1) is an offence of strict liability and that *mens rea* is not an ingredient of the offence. Jessup, J. stated: "in my opinion the Legislature intended that the maker of a materially misleading representation should take the risk and that the public should be protected irrespective of the guilt or innocence of the maker subject to the exception provided by s-s. (2)."

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[37] (1965), 46 C.P.R. 239, [1966] 1 C.C.C. 220, [1965] 2 O.R. 628 (H.C.J.).

The onus is on the Crown to establish a representation to that portion of the public to which the advertisement is directed that the price indicated as the list price is the price at which the article is ordinarily sold in the area covered by the advertisement and that in fact that price is not the price at which the article is ordinarily sold in that area. The placing together in an advertisement of two prices, one referred to as a list price and the other as the price at which the retailer was offering the goods for sale, is an invitation to the public to compare the two prices for the purpose of promoting a sale. In *R. v. Featherweight Mattress Ltd.*,[38] the accused was convicted of making a materially misleading representation to the public concerning the price at which mattresses are ordinarily sold. The Court held that the Crown had satisfied the onus of establishing the price at which the products are ordinarily sold by producing evidence of the pricing of a similar product in the market.

Also in considering the issue of *mens rea*, the Manitoba County Court in *R. v. Genser & Sons Ltd.*,[39] held that while there may be a presumption that *mens rea* is an essential ingredient of every offence, such a presumption can be displaced by words creating the offence or by the subject matter of the legislation. The Court found that the subject matter of the act together with the wording of subsection (2) of Section 33C, when read together implies that Section 33C(1) does not require the proof of *mens rea* or knowledge of the wrongful act. In *R. v. Colgate-Palmolive Ltd.*,[40] the test was stated to be: Would a reasonable shopper draw the conclusion from the advertisement including the words that he was being offered a product at a price below which that product is ordinarily sold. If he answers yes, would such a representation be true. On the facts of the case, the representation was untrue and a conviction was entered. However, the Court took into account the lack of intent, the cooperation of the accused and the "newness" of the offence and made no order as to fine or costs.

In *R. v. Podersky's Ltd.*,[41] in dismissing a charge of making a materially misleading representation to the public concerning the price at which television sets are ordinarily sold, the Court found that the Crown had failed to discharge the onus on it of establishing the ordinary price in the trading area. The Court held that it could not accept an isolated transaction as evidence of an ordinary selling price.

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[38] Unreported, July 19, 1955, Ont. Mag. Ct.

[39] (1969), 61 C.P.R. 80 (Man. Co. Ct.).

[40] (1969), 57 C.P.R. 221, 3 D.L.R. (3d) 707, [1970] 1 C.C.C. 100 (Ont. Co. Ct.).

[41] (1968), 58 C.P.R. 140 (Alta. Mag. Ct.).

In *R. v. Patents Place Ltd.*,[42] it was stated that the word "material" must bear its normal meaning and that it relates to a representation which is calculated to and in effect does lead a person to a certain course of conduct because he believes the information put before him indicates that this would be advantageous to himself. The criteria of the word "material" was also dealt with in the case of *R. v. Kelly's on Seymour Ltd.*[43] It was stated that such criteria was not the value to the purchaser but rather the degree to which the purchaser is affected by these words in coming to a conclusion as to whether or not he should make the purchase.

The Court is entitled to consider the prices at which the article in question has been sold by the accused and is not limited to only a consideration of the prices at which they have been sold by its competitors in the trading area: *R. v. MacKay's Television and Appliances Ltd.*[44]

The intent of the legislation as stated in *R. v. Conklin Lumber Co.*[45] is to prohibit the retailer from misleading a prospective purchaser into believing that he is being given a greater bargain than he actually is to the detriment not only of the purchaser but also to other retailers in the business. However, in *R. v. Television Accessories and Tubes Ltd.*,[46] the Ontario Provincial Court, in dismissing a charge against the accused of making a materially misleading representation as to price, found that while the advertisement could in some respects have been misleading to people, it wasn't a large advertisement, the accused didn't do much advertising, and there was no deliberate attempt to mislead the public. Also, in *R. v. A.E. Hickman Co. Ltd.*,[47] the Court ruled that an isolated instance of a sale by a competitor below the price advertised as the regular price by the accused does not establish that the representation made was misleading. The Court dismissed the action finding that two isolated transactions at prices below the price advertised as the regular price did not constitute sufficient evidence of the prices at which the article was ordinarily sold within the meaning of the legislation.

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42. (1968), 57 C.P.R. 12 (Ont. Mag. Ct.).

43. (1969), 60 C.P.R. 24 (B.C. Mag. Ct.).

44. (1970), 65 C.P.R. 126 (Ont. Co. Ct.).

45. (1970), 63 C.P.R. 161 (Ont. Prov. Ct.).

46. (1970), 1 C.P.R. (2d) 213 (Ont. Prov. Ct.).

47. (1971), 3 C.P.R. (2d) 175 (Nfld. Mag. Ct.).

In *R. v. J. Pascal Hardware Co.*,[48] the elements of the offence needed to be established by the Crown were stated to be: that the representation must be materially misleading; that the material misrepresentation must be as to the price at which an article was sold, is ordinarily sold or contemplated to be sold; and that the material misrepresentation must be for the purpose of promoting the sale or use of the article. The Crown must show that the price which is alleged to have been materially misleading was not the price ordinarily charged in the area. The price at which an article is ordinarily sold within the meaning of the Section is not the price at which the person making the representation ordinarily sells it. What is meant is the price at which it is ordinarily sold generally in the area in which the representation was made. The governing price is not the price at which the accused himself would normally sell the item. The use of the word "regular" is a representation that the price is in fact that which other merchants would charge for the same product but cannot only be what the accused himself would ordinarily charge. Fogarty, Co. Ct. J. stated that while *mens rea* is not essential for a conviction under this Section, this subjective aspect is of importance in the matter of penalty:

> This section is designed to protect the public as well as the trade. It matters a great deal what moneys are involved, what profits are involved, and to what extent the public may be involved. It matters also whether this was flagrant breach of the law.

Here the company had erred in using its own regular price list and was found guilty on a technicality. A fine of $200 was imposed. More generally, see Table 1.

The provisions of the Act refer to the price which the product is in fact ordinarily sold and not the defendant's belief as to what that ordinary or regular selling price is: *R. v. Andre Lalonde Sports Inc.*[49]

In *R. v. Shaheen Enterprises Ltd.*,[50] it was stated that the onus on the Crown is to prove beyond a reasonable doubt that the accused corporation made the representation in question to the public for the purpose of promoting the sale of an article; that the representation concerned the price at which the article had ordinarily been sold; and that there was conveyed to the public by the accused a materially misleading representation. The Crown was not obliged to prove that a member of the public had in fact relied upon such representation to his detriment. The offence is one of strict liability and *mens rea* is not required and if the Crown has established that the advertisement was in fact materially misleading, it need not prove that the accused knew it to be so. The legislation is intended not only to protect the consuming public but also to protect competitors in the business field.

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[48] (1972), 8 C.P.R. (2d) 155 (Ont. Co. Ct.).

[49] (1972), 9 C.P.R. (2d) 187, 11 C.C.C. (2d) 418 (Que. Sess. Peace).

[50] (1975), 28 C.P.R. (2d) 148 (Sask. Dist. Ct.).

In *R. v. NR Motors Ltd.*,[51] the evidence called by the Crown failed to show that the dealers in neighbouring towns were competitors of the accused in the relevant market. The test is whether, on the evidence before the Court, the prices introduced by the Crown are prices in a relevant market. The extent of the area which ought to be the guide to interpretation is a question of fact to be decided on the evidence and with regard to all the circumstances in the case.

2.8 Deemed Representation, S.52(2)

The object of Section 52(2) is to make certain representations that are not representations to the public, grounds for liability by deeming them to be representations to the public but only by the person who caused them to be made: *R. v. Yukon Automobile Brokers Ltd.*[52] The Section relieves those who did not cause the representation to be made. It refers to representations with respect to: (a) those expressed on an article offered or displayed for sale, its wrapper or container; (b) those expressed on anything attached to, inserted in or accompanying an article offered or displayed for sale, its wrapper or container, or anything on which the article is mounted for display or sale; (c) those expressed on an in-store or other point-of-purchase display; (d) representations made in the course of in-store, door-to-door or telephone selling to a person as ultimate user; or (e) representations contained in or on anything that is sold, sent, delivered, transmitted or in any other manner whatever made available to a member of the public.

In *R. v. Simpson Sears Ltd.*,[53] the accused took part in a scheme promoting the sale of diamonds at a significant reduction "off appraised value". Integral to the scheme was the provision of an appraisal certificate along with each diamond sold setting out the quality and the retail value of the ring. The representation in the appraisal certificates were found to be false and misleading. The appraisal certificates fell within the provision as a deemed representation under Section 36(2)(b). The appraisal certificates were used as selling tools and were part of the parcel of what the purchasers received along with the rings. The fact that the certificates may have been mailed to the purchaser rather than handed over at the time of sale did not remove its character as a representation accompanying an article offered for sale.

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[51] (1979), 55 C.P.R. (2d) 168, [1979] 2 W.W.R. 614 (B.C. Co. Ct.).

[52] (1979), 50 C.P.R. (2d) 81 (Y.T.S.C.).

[53] Unreported, May 13, 1983, Ont. Co. Ct..

In *R. v. KBM Electropedic Adjustable Beds Ltd.*,[54] the accused's product was sold by independent salesmen who had also altered some wording in the accused's brochure. Although the accused is responsible for everything contained in its brochure as printed there was no evidence that the accused caused, authorized, approved or knew of alterations to the brochure. The deeming clause in s. 36(2) militates against the application of the common law doctrine that a principal is responsible for the acts of his agent outside his actual authority but within his ostensible or apparent authority.

2.9 Penalties/Remedies

Although the Act prescribes punishment for the offense as a fine or a term of imprisonment, the courts are empowered by section 34 to issue a prohibition order against a person convicted of an offense under Part V of the *Competition Act* which includes misleading advertising. The court's discretion to make an order of prohibition appears to be influenced largely by the likelihood of the continuation or repetition of the offense, and an application for such an order has been rejected where an offending corporation discontinued of its own volition a misleading advertisement. Essentially the Crown has to demonstrate and not merely allege a risk of repetition or continuation.

It has been stated that the first consideration in determining an appropriate sentence is the same as with any other criminal offense: protection of the public interest. The relevant criteria was reviewed in *R. v. Browning Arms Company of Canada Limited*[55] and includes: deterrence to the convicted corporation and others who may be tempted to break the law; the size of the convicted corporation; the scale of its operations; the range of products sold by it and of products affected by the illegal practice; the nature of the market itself; the number of competitors and sentences imposed in the past. The Court in *R. v. Dupuis et Freres Ltee*,[56] took into consideration the seriousness of the offence, the possibility of repetition, the renown and the influence on the public of the company involved and especially the necessity of discouraging merchants with small or large firms who might be tempted to resort to similar false advertising in order to hoodwink the public and abuse its good faith.

While the offense is not a trivial one and is indictable and fines can be substantial,the courts have traditionally been reluctant to impose heavy fines. For example, in *R. v. Simpson Sears Limited*,[57] the company had a very bad record consisting of eight convictions over 10 years. The court found that the past level of fines indicated that the company viewed them as a license only and they had no deterrent effect. Over $7,000,000 worth of diamond rings were sold in a scheme for a gross profit of over $3,000,000. The company was aware that it was breaking the law and continued to do so even after being convicted for the identical scheme previously and continued to do so during the investigation of the charge at issue. A total fine of $1,000,000 was imposed.

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[54] (1983), 75 C.P.R. (2d) 58, 50 A.R. 76 (Q.B.).

[55] (1974), 18 C.C.C. (2d) 298, 15 C.P.R. (2d) 97 (Ont. C.A.).

[56] (1971), 5 C.P.R. (2d) 176 (Que. Sess. Peace).

[57] [1985] C.C.L. 11437 (Ont. Co. Ct.).

In *R. v. Caskie Furs Regina Limited*[58] the accused were charged with 16 counts of making false or misleading representations to the public through radio commercials and newspaper advertisements as to the usual retail price of fur coats, contrary to Section 52(1)(a) formerly Section 36(1)(a). The court found the accused guilty as charged. The court also agreed with the crown's submission that the fine should be divided equally amongst the 16 counts and assessed 80% to 90% against the corporate accused and the balance against the accused individual. The court ruled that the fine must be in an amount that will bring home to the accused that they have deliberately and knowingly violated the law in the hope of achieving economic gain. The fact that the public was not actually mislead by the advertising did not act in mitigation of the accused's conduct. Since the fine must be more than a mere license fee, and must be sufficient to remove profits and be felt by the offenders in order to act as a general deterrent, the fine was assessed at $48,000.

The aspect of deterrence to others who might be tempted to commit similar offenses is clearly an important factor to be taken into account. The penalty imposed must not be so small as to be regarded by the accused or by other corporations as a mere license fee for carrying on business in a manner contrary to law: *R. v. Simpson-Sears Ltd.*[59]

In 1989/90 some novel penalties/remedies were applied.

> In *R. v. Michael J. Chater and M.C. Beautician Limited*, a case involving the marketing of a baldness treatment, Mr. Chater was placed on probation for one year and ordered to perform 150 hours of community service. In *R. v. Carburation Econex Canada Inc. and Raymond Ray*, a case involving the marketing of a fuel saving device, Mr. Roy was sentenced to make a donation of $4,000 to the Association de la Protection des Automobilistes. The accused in both cases had pleaded guilty.
>
> As well, during 1989-90, Robert MacElwain was required to commence serving a six-month prison sentence for failure to pay a total fine of $30,000 imposed in 1988 after convictions under sections 52(1)(a), (b) and (c).[60]

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[58] Unreported, May 9, 1988, Sask. Prov. Ct..

[59] *Supra*, note 57.

[60] Bureau of Competition Policy, *Misleading Advertising Bulletin*, Vol. 4, 1990, p. 9.

The Bureau of Competition Policy's *Annual Report* and the *Misleading Advertising Bulletin* contain data on the size of fines levied under this provision. See also Table 1.

3.0 DOUBLE TICKETING, S.54

Section 54(1) is to the effect that if a product is labelled with two or more prices it is an offence to supply the product at a price higher than the lowest price with which the product is labelled. The prices need not both be on the product itself (e.g. one tag on the product, the other on the shelf on which it is displayed). There will also be a breach of the provision if one tag was placed by the retailer and the other by the manufacturer. Any person who contravenes subsection (1) is guilty of an offence and liable on summary conviction to a fine not exceeding $10,000 or to imprisonment for a term not exceeding one year or to both.

4.0 PYRAMID SELLING, S.55

It was in 1976 that amendments to the *Combines Investigation Act* prohibited pyramid selling. However s. 55(4) specifies that the prohibition does not apply to those schemes which are otherwise permitted by provincial legislation.

Section 55(l)(a) defines a scheme of pyramid selling as a scheme for the sale or lease of a product whereby one person pays a fee to participate in the scheme and receives the right to receive a fee, commission or other benefit. Such benefit may be in respect of the recruitment into the scheme of other persons or in respect of sales or leases made to other persons recruited into the scheme. Section 55(l)(b) also defines pyramid selling as a scheme for the sale or lease of a product whereby one person sells or leases a product to another who receives the right to a rebate, commission or other benefit.

As the number of participants multiplies, a large number of sales can be made and commissions paid without the product coming into the hands of a consumer. The offense is therefore to invite or induce persons into the scheme. The classic form of pyramid selling occurs whereby a person receives a benefit by virtue of the sale of the product when that person had nothing to do with the sale or purchase of the product.

The offense can be pursued on indictment and if so a fine in the discretion of the court or imprisonment for a term not exceeding five years or both can be imposed. On summary conviction, a fine not exceeding $25,000 or imprisonment for a term not exceeding one year or both are provided for (see S.55(3)).

In *R. v. Boivin*,[61] the accused operated a scheme whereby agents sold membership cards which could be used to obtain discounts from retailers. Agents had to pay the corporation a $25 membership fee, a $50 annual work permit fee and had to enrol at least 12 members per year to remain eligible. Since the system of remuneration allowed recruiting agents to earn commissions on the sales of others it constituted a scheme of pyramid selling. L'Heureux-Dube J.A. stated:

> Finally, the types of activities in which the appellants were involved are precisely those kinds that the Act prohibits because these activities constitute enticements which, overall, only serve the interests of the promoters to the detriment of those who invest in them their illusions, money, and energy, and who most often never get much, if anything, in return.

The company was fined $15,000 and the two individual accused fined $2,500 each.

Although a company is found guilty, there must be more evidence than the mere fact that one is a director of an offending corporation to establish the personal criminal liability of that director: there must usually be evidence that the individual held office during the offending conduct: *R. v. Itec Gold Marketing Inc.*[62]

In *R. v. Shaklee Canada Inc.*,[63] the Alberta Court of Appeal held that the activities complained of did constitute the offence and that it had jurisdiction pursuant to S.30(4) to make an Order of Prohibition. The Court found that pyramid selling is the type of offence which can more effectively be dealt with by a prohibition order.

In *R. v. CLP Canmarket Lifestyle Products Corp.*,[64] the appellants argued that because some but not all provinces had enacted legislation governing pyramid selling, there was a breach of s. 15 of the Charter. The application was dismissed on the basis that it would be untenable to allow provincial variations in the application of federal law: *A.-G. Ont. v. Canada Temperance Federation*.[65] Regional disparity in the application of the law is not of itself a violation of s. 15 of the *Charter*.

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[61] (1986), 28 C.C.C. (3d) 129.

[62] Unreported, May 7, 1987, Alta. Prov. Ct..

[63] *Supra*, note 1.

[64] (1987), 19 C.P.R. (3d) 342, [198] 2 W.W.R. 170, 50 Man. R. (2d) 106 (C.A.).

[65] [1946] A.C. 193, [1946] 2 D.L.R. 1, 85 C.C.C. 225.

5.0 REFERRAL SELLING, S.56

The offence of referral selling occurs when one person induces another to purchase or lease a product while representing that some rebate, commission or other benefit may accrue to that person in return for the names of others with whom the first person may make a similar transaction.

The section's objective is to discourage the practice of inducing individuals to purchase on the strength of the prospect of a future benefit. Such purchasing decisions could very well not be based on the quality of the product.

As in the case of pyramid selling, the actual offense of referral selling is the invitation or inducement to participate in the scheme, and does not apply if Provincial Legislation allows it. The penalty is also the same.

An example of referral selling is the case of *R. v. Sunrise Industries*,[66] where the accused promoted its product by offering a gift or $25 commission to new customers who provided names of other persons who subsequently joined the program. The accused pleaded guilty to nine charges under the section and was fined a total of $2,700. In *R. v. World Book Childcraft of Canada Ltd.*,[67] the representative of the accused company provided a school with a free encyclopedia on condition that the principal write the parents of school pupils about the encyclopedia. The accused was acquitted because there was no purchase or lease of a product by the school.

6.0 BAIT AND SWITCH SELLING, S.57

Under section 57 of the *Competition Act*, it is an offence to advertise a product at a bargain price when that product is not available in reasonable quantities. The criteria determining a reasonable quantity includes the nature of the advertiser's business, the market in which he does business and the advertisement itself. If an advertiser has made reasonable efforts to obtain a reasonable quantity of the product but has been unable to do so due to events beyond his control, he will not be liable. Many advertisers make use of a "raincheck" policy which is also a statutory defence to a charge under S.57. The object of S.57 is to forbid advertisers from advertising products in limited supply at low prices for the sole purpose of attracting customers to a retail location when there is little chance they can purchase the product advertised.

In *R. v. Clarke*,[68] the accused was found guilty when he advertised a bargain price of air conditioners in a large market area when he only had three damaged units in stock and no expectation of receiving more. It was stated that a bargain price is a price that is represented to be such whether it is in fact or not.

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[66] Unreported, May 9, 1977, Que. Ct. of Sess. Peace.

[67] (1981) 62, C.P.R. (2d) 70, 31 Nfld. & P.E.I.R. 69 (Nfld. Dist. Ct.).

[68] Unreported, June 18, 1979, Ont. Co. Ct..

In *R. v. Air Canada*,[69] the accused published advertisements for a seat sale aimed at a combined readership of 1.15 million people at a time when there were 38 actual and 76 notional seats left for the destinations advertised. Callers responding to the advertisement after the sale seats were unavailable were offered seats at a higher price. The accused was found guilty of the offence charged. The warning in the advertisements that "some flights may be sold out" were found to be irrelevant since the section imposes a positive obligation not to advertise unless reasonable quantities are available.

The *Misleading Advertising Bulletin* of October/December, 1977 stated to the effect that the use of words such as "sale price" or "special" bring an advertisement within this section. An advertisement for a product at a price significantly lower than the normal market price also falls within the provision, even if there is no direct statement in the advertisement that the advertised price is a bargain price.

7.0 SALE ABOVE ADVERTISED PRICE, S.58

It is an offence under s. 58 of the *Act* to sell or rent a product in a market at a price higher than the advertised price during the periods for which the advertised price is in effect. The section will not apply in respect of an advertisement in a catalogue if it is stated that the prices contained therein are subject to error, if the person can establish that the price advertised is an error; in respect of an advertisement that is immediately followed by another advertisement correcting the price first mentioned; in respect of the sale of a security obtained on the open market during a period when the prospectus relating to that security is still current; or in respect of a sale of a product by a person who is not engaged in the business of dealing with that product.

In *R. v. Supermarches Dominion Ltee.*,[70] the advertisement in question cost approximately $3,000 and generated approximately $100,000 in business. The accused, in an effort to show lack of intent, acknowledged that its supervision system was inadequate, that there was no malicious intent and that the matter was due to a lack of full time staff, inexperienced staff and took place during a busy holiday period. The Court found that the advertisements were specifically placed to attract customers to its stores and once there customers paid prices above the advertised prices. Although the accused may have taken steps to prevent such occurrence, the evidence disclosed that this had been happening weekly for a period of three years. The Appeal Court, given that the offence is a federal one, took into account the level of fines in other jurisdictions, and fined the accused $800 on each of 35 counts.

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[69] (1987), 17 C.P.R. (3d) 392 (Ont. Dist. Ct.).

[70] Unreported, Feb. 25, 1980, Que. S.C..

In *R. v. Jean-Paul Dorion Inc.*,[71] the accused grocery store operator was charged with selling products above advertised price contrary to the former s. 37.1. The accused argued that while individual goods might have retained the preadvertised price, display cards on the shelf indicated that the items were on sale and cashiers were instructed to take notice of the advertised prices when ringing the items in. Each cashier was given a copy of the advertisement and instructed to only enter those prices. The court held that the offence created by the section was one of strict liability falling in the second category of *City of Sault Ste.-Marie*[72] and therefore that the defendant could raise due diligence as a defence. However the court held that the accused could have implemented a control system to ensure that the sales were not at prices above the advertised prices. The court also held that the accused was negligent and did not exercise due diligence. He was convicted on all 41 counts.

8.0 PROMOTIONAL CONTESTS, S.59

Promotional contests have become a popular way of advertising one's products. However one may not use promotional contests in connection with the sale of any product unless the contest is otherwise lawful. There must be full disclosure of the number and approximate value of the prizes, of the area to which they relate and of any fact within the knowledge of the advertiser that materially affects the chances of winning. The *Act* also requires that distribution of the prizes not be unduly delayed and that such distribution or selection of participants be made randomly or on the basis of skill.

In *R. v. O.E. McIntyre Ltd.*,[73] the accused, in advertisements involving promotional contests, offered such contests in three different magazines with different terms and conditions and completion dates, giving the impression that there were three separate contests when in fact it was offering a single contest. The accused was found guilty of misleading advertising.

In *R. v. Pepsi Cola Canada Ltd.*,[74] the accused pleaded guilty to one charge under s. 37.2 (now s. 59). The contest rules provided for a draw for an automobile from 150 entries whereas the draw was made from 300 entries. The error was that of a lower level employee and was not known to or consented to by the head office. Under the circumstances the appropriate fine was held to be $2,000.

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[71] Unreported, May 16, 1980, Que. Sess. Peace.

[72] [1978] 2 S.C.R. 1299.

[73] (1972), 9 C.P.R. (2d) 105 (Que. Sess. Peace).

[74] (1986), 14 C.P.R. (3d) 399 (Ont. Prov. Ct.).

When a corporation is aiming its advertising at children, there is a higher standard of care required: *R. V. Lowney Inc.*.[75]

The *Misleading Advertising Bulletin* of August, 1976 specified that disclosure should be made in a reasonably conspicuous manner at some time before the potential contest participant is committed to the advertiser's product or to the contest. The approximate value of the prize is the approximate regular market value of the product.

In *R. v. Kraft Foods Ltd.*,[76] the accused advertised a contest with the words "Fifteen chances to win fifteen prizes". Because prizes were awarded regionally with some regions having less available prizes and because the competition lasted for thirteen weeks with draws taking place throughout, the competitors in certain regions were selected before many contestants had entered the contest in that region. They were therefore precluded from winning the prize although the advertising continued.

9.0 DEFENCES, S.60

The defences set out in s. 60 have been touched upon earlier. Subsection (1) states that sections 52 to 59 do not apply to a person who advertises on behalf of another person in Canada, at least if he obtained and recorded the name and address of such person, and accepted the advertisement on good faith.

Section 60(2) pertains to defences available with respect to sections 52 and 53 of the Act. No conviction will arise under these sections if the accused can establish that: (a) the act or omission giving rise to the offence was the result of an error; (b) reasonable precautions and due diligence were exercised to prevent the occurrence of such error; (c) reasonable measures were taken to bring the error to the attention of those likely to have been reached by the representation; (d) the reasonable measures referred to in (c), except with regard to securities, were taken forthwith after the representation was made.

In *R. v. Bennett Stores Ltd.*,[77] an error appeared in a newspaper advertisement at the fault of the newspaper publisher. The error was not in the copies supplied by the advertiser to the newspaper nor did the error appear in other papers. In view of the longstanding relationship between the advertiser and the newspaper, along with the fact that it could not be pointed out that any error had occurred in the past, the court was satisfied that the company took reasonable precautions and exercised due diligence to see that errors in advertising did not occur. The manager did not check the advertising and did not learn of the error until many months after when it was too late to do anything about it. Although once an error comes to the attention of a merchant he must publish a correcting advertisement, the court was convinced that the firm would have taken reasonable measures had it known about the error and this was sufficient.

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[75] (1984), 13 W.C.B. 47 (Ont. Prov. Ct.).

[76] (1972), 11 C.P.R. (2d) 240, 36 D.L.R. (3d), 11 C.C.C. (2d) 406 (Que. Q.B.).

[77] (1977), 46 C.P.R. (2d) 136 (B.C. Prov. Ct.).

The statutory defence in s. 37.3(2) (now s. 60(2)) excludes common law due diligence and therefore all four elements of the statutory provision must be satisfied: *R. v. Consumers Distributing Co. Ltd.*.[78] The burden is on the accused to establish the defence of due diligence on a balance of probabilities. The Court of Appeal decision in *R. v. The Wholesale Travel Group* held that S.37.3(2)(c) and (d) are unconstitutional and that S.36(1)(a) combined with S.37(2)(a) and (b) is at most a strict liability offense.

10.0 THE STANDARD OF PROOF

Few people would disagree that the public requires protection against deceptive marketing practices such as those identified in the *Competition Act*. The real question is what constitutes the most efficient approach or method by which such an objective can be achieved. Conventional wisdom about such offenses has long been that the best protection can be secured by resorting to the criminal law. However if one keeps in mind that the prime consideration should be the harm done to the public, this is not necessarily so. Some argue that whether or not the defendant has been at fault should be secondary for it has no bearing on damage done to the consumer. The main question should not be "was the defendant at fault?", but rather "how can we prevent or undo the harm?"

It is suggested that more emphasis should be put on education and enforcement remedies. Although criminal sanctions can have an educational impact by way of deterrence, it cannot be denied that such deterrence has had limited success in more than one instance. This is particularly the case for the large corporation that can afford to pay even heavy fines which do not outweigh the potential profit created by the misleading representation. Criminal sanctions can only punish the defendant for his wrongdoing in the hope of teaching him a lesson and setting an example to others for the future. Enforcement remedies on the other hand can deal specifically with the harm done, with economic imbalance caused by the misrepresentation.

Prohibition Orders can be most effective in redressing the imblance. Whereas normally conviction results in a fine, a Prohibition Order speaks to the individual and disobedience can carry severe personal legal consequences to corporate directors. A prohibition order can theoretically be unlimited in respect of time and can affect the operations of a whole chain of stores and therefore the total operation of a company.

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[78] (1980), 54 C.P.R. (2d) 50, 57 C.C.C. (2d) 317 (Ont. C.A.).

Imposed corrective counter-advertisements can also be more effective than the criminal law. If one takes for example a television commercial constantly repeated and totally misleading, there is little criminal sanctions against the perpetrator can do to remove the false impression that the advertisement has created in the minds of the public. However, imposed corrective advertisements can do so and thus restores the economic/market imbalance originally created by the misleading representation.

In this light the only remaining function for the criminal law would be of supporting such enforcement remedies. The advertiser who disobeys an order to counter-advertise or any prohibition order is wilfully disobeying a court order and should rightly be dealt with by resorting to the criminal law.

The Bureau of Competition Policy has also taken the position that encouraging competition can be pursued with greater effectiveness and certainty, and with less time and expense, through an approach to enforcement which stresses the promotion of continuing voluntary compliance with the *Competition Act*.[79] The Director attempts to encourage general compliance with the Act through a program of communication and education.

Compliance with the Act can best be achieved when businessmen have a sound understanding of its provisions. Emphasis must be put on communication and education to foster a better understanding of the Act and its application. To this effect the Director and senior staff of the Bureau will, on request, conduct seminars for businesses and associations on topics of particular interest to them. The Bureau also makes several publications available through various offices, including the *Misleading Advertising Bulletin* which contains information relating to the misleading advertising and deceptive marketing practices provisions of the Act. In addition, the Bureau published Information Bulletin No. 3, *Program of Compliance* in June 1989.

The Director also facilitates compliance by providing advisory opinions to those who wish to avoid coming into conflict with the Act.[80] Company officials, lawyers and others may seek an opinion from the Bureau on whether the implementation of a proposed business plan or practice would give the Director grounds to initiate an inquiry under the Act. Those who seek an opinion are not bound by the advice provided and remain free to adopt the plan or practice in question on the understanding that the matter may be tested before the courts. The number of oral advisory opinions rose from 745 in 1985/86 to 1,124 in 1989/90. The number of written advisory opinions has been about 300 p.a. over the same period - see Table 2.

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[79] For example, the Voluntary Advertising Guidelines of the Toronto Home Builders' Association can be found in the Bureau of Competition Policy, *Misleading Advertising Bulletin*, Vol. 3, April-June, 1990, pp. 3-7.

[80] See Bureau of Competition Policy, *Misleading Advertising Bulletin*, Vol. 4, 1990, pp. 11-12.

The Compliance approach would thus appear to offer the benefits of flexibility and efficiency, both of which are sometimes perceived to be lacking in the criminal process.

Table 1

MARKETING PRACTICES BRANCH CONVICTIONS AND FINES, 1985/86 TO 1989/90

	1985/86	1986/87	1987/88	1988/89	1989/90
Accused Convicted[1]	128	131	125	99	59
Section					
• 52(1)(a)	87	80	78	73	37
• 52(1)(b)	10	12	6	9	7
• 52(1)(c)	1	2	0	2	0
• 52(1)(d)	18	20	8	9	8
• 54	0	0	1	0	0
• 55	0	3	2	1	0
• 57	3	5	24	3	2
• 58	4	4	2	1	2
• 59	4	5	4	1	3
Average Fine per Case:					
• 52(1)(a)	$ 6,561	$ 7,608	$ 8,232	$10,538	$10,854
• 52(1)(b)	2,028	5,919	3,030	3,569	29,786
• 52(1)(c)	-	20,000	-	6,500	-
• 52(1)(d)	3,705	4,809	6,925	4,978	20,781
• 54	-	-	2,000	-	-
• 55	30,500	20,000	4,250	8,000	-
• 57	18,750	2,400	52,660	4,500	8,500
• 58	5,875	3,562	1,875	4,500	19,000
• 59	700	2,740	5,625	9,000	1,667
All sections	$ 6,384	$ 7,120	$10,430	$ 9,033	$14,175

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[1] Number of individuals or corporations.

Sources: Derived from Bureau of Competition Policy, *Misleading Advertising Bulletin*, Vol. 4, 1990, p. 8; and Issue 1, 1989, p. 3.

Table 2

ACTIVITY MEASURES AND ALTERNATIVE CASE RESOLUTIONS, MARKETING PRACTICES BRANCH, 1985/86 TO 1989/90

	1985/86	1986/87	1987/88	1988/89	1989/90
• **Information and Compliance Activities**					
• Requests for Information	19,224	21,051	21,937	24,983	27,122
• Oral Advisory Opinions	745	938	1,089	1,007	1,124
• Written Advisory Opinions	307	343	296	377	274
• Media Contacts	189	277	224	235	274
• Speeches/Educational Seminars	146	161	188	184	121
• **Alternative Case Resolutions**					
• Prohibition Orders	n.a.	0	2	3	5
• Undertakings	n.a.	0	0	0	8
• Information Contacts	n.a.	1,306	1,517	1,325	1,310

Sources: Bureau of Competition Policy, *Misleading Advertising Bulletin*, Vol. 4, 1990, p. 7; and Issue No. 1, October-December 1989, p. 5.

Chapter 18

REFORMING FEDERAL MISLEADING ADVERTISING LAW: REVIEW AND PROGNOSIS

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1.0 INTRODUCTION

The most recent significant changes to the misleading advertising provisions in Canada's competition legislation took place in 1976.[1] Except for the enactment of the new purpose section of the Act,[2] revamped search powers[3] and two minor amendments, the deceptive marketing practices part of the legislation has remained unchanged.

First impressions, however, can be misleading in their own right. The Director's administration of the provisions has changed markedly over the interval.[4] The advent of Advisory Opinions, advance consultations and the *Misleading Advertising Bulletin* underlie a concerted effort to encourage voluntary compliance through communication and education programs, particularly to the business community. On the enforcement side, there are signs of initiatives through Orders of Prohibition and Undertakings[5] to resolve cases in lieu of prosecutions.

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[1] *Combines Investigation Act*, S.C. 1974-75-76, c.76.

[2] *Competition Act*, S.C. 1986, c.26, s.19; now R.S.C., 1985, c. C-34 (effective December 12, 1988).

[3] *Ibid.*, s.24, following *Southam Inc. v. Hunter* [1984] 2 S.C.R. 145, 11 D.L.R. (4th) 641. Sections 58(3) and 59(1) [French version only] were amended as well.

[4] See W. Chris Martin, "Misleading Advertising and Deceptive Marketing Practices: The Evolution of Legislation, Adjudication and Administration" in R.S. Khemani and W.T. Stanbury (eds.) *Historical Perspectives on Canadian Competition Policy* (Halifax: The Institute for Research on Public Policy, 1991).

The overall thrust of the Act's administration in recent years has been to improve compliance through prevention, to negotiate compliance in some test cases and to prosecute public impact cases with a high deterrence value.

None of these operational choices is evident, necessary or predictable from the face of the *Competition Act*. Except for the civil damages provision[6] (which has been used only once in a misleading advertising case so far as I am aware), the advertising provisions are cast in criminal law terms as general and specific prohibitions against misleading claims, representations and comparisons. Under the Act, misleading advertising is an offence punishable by fine or imprisonment or both.

If the misleading advertising provisions are not, therefore, admittedly "regulatory in nature,"[7] they are being actively administered by the Marketing Practices Branch in a compliance - directed manner that belies their *prima facie* criminal law mould. We are talking here of an enforcement philosophy and approach that go beyond traditional questions of prosecutorial direction caused by limited staff and financial resources.

What we have, in no small measure, is a compliance-oriented Branch moving in step with the Director's overall emphasis on preventive and negotiated compliance programs for the rest of the Act. And this is taking place, with approval in most quarters, within a static legislative framework.

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[5] For example, see 2 *Misleading Advertising Bulletin* 6, "Alternative Case Resolutions" (Jan.-Mar. 1989) and the paper by Addy in Part 6 of this volume.

[6] Constitutionally upheld by the S.C.C. in *General Motors of Canada v. City National Leasing* (1989), 93 N.R. 326 and *Quebec Ready Mix Inc. et.al. v. Rocois Construction Inc.* (1989), 93 N.R. 388 reported in 10 *Canadian Competition Policy Record* (No.2) 1 (June 1989). The section in question (s.31.1, now s.36) "has been rarely used in cases of misleading advertising" because "individual consumer losses from deceptive advertising are insufficient to support separate recovery suits" *Misleading Advertising: Report of the Standing Committee on Consumer and Corporate Affairs*, House of Commons Canada, Ottawa, June 1988 at p. 35 [hereinafter *1988 Report*]. The only known consumer plaintiff case was *Graff v. Midwest Motors (1966) Ltd.* cited in 3 *Misleading Advertising Bulletin* 6 (1978). On the other hand, a claim based, in part on Section 36 has been brought by a major food retailer in Vancouver against a competitor company concerning an allegation that the defendant chain falsely claims that it can "beat or meet" the plaintiff's prices: *Westfair Foods Ltd. v. Jim Pattison Industries* (B.C. Supreme Court, Vancouver Registry A890758), discussed in Vancouver *Sun*, October 28, 1988, p. A10. The amended Statement of Claim seeks, *inter alia*, a declaration that the defendant's claims contravene the *Competition Act* (Section 52), similar provisions of the B.C. *Trade Practice Act*; injunctive relief under the same Acts and damages under both statutes, with costs under Section 36 of the *Competition Act*.

[7] *1988 Report*, p. 1.

2.0 THE GENESIS OF CHANGE

This is not to suggest a dearth of proposals to reform the misleading advertising provisions in the *Competition Act* or its predecessor statute, the *Combines Investigation Act*. In the mid-1970s, a major report[8] conducted for the Department of Consumer and Corporate Affairs by Professor Michael Trebilcock recommended a model trade practices Act featuring civil injunctive and consumer redress provisions. Active discussions were held with the provincial governments[9] to explore the possibilities for a national regulatory scheme for the shared administration of marketing practices legislation. The essential ingredients of these various proposals bear a remarkable similarity to the June 1988 recommendations of the Commons Standing Committee on Consumer and Corporate Affairs, chaired by Mary Collins M.P., now the Associate Minister of Defence.

The House Committee identified three principal objectives in its assessment of the Competition Act approach to misleading advertising, namely: redress for the victims of such advertising; deterrence of violations, and "the creation of a more flexible, cost-effective system for handling misleading advertising offices."[10]

Thirty-three recommendations were made by the Collins Committee. Their main thrust, as aptly summarized by another academic commentator,[11] is to "acknowledge the limitations of a criminal approach to false advertising and to recommend that existing provisions be supplemented by a broader range of remedies, including a consumer class provision, a more readily available injunction power, a judicial power to order advertisers to engage in corrective advertising and affirmative disclosure of facts, and a capacity in the Director...to enter into consent agreements or assurances of voluntary compliance with advertisers".

In large part, the proposals mirror the features of provincial trade practices statutes, particularly in British Columbia,[12] that have been in effect since the mid or late 1970's. In this respect, the provincial experience should be considered in assessing the efficacy and desirability of the Committee's recommendations.

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[8] M.J. Trebilcock et al., *A Study on Consumer Misleading and Unfair Trade Practices: Proposed Policy Directions for the Reform of the Regulation of Unfair Trade Practices in Canada*, Vol. 1, (1976, prepared for Consumer and Corporate Affairs Canada) [hereinafter '1976 Study'].

[9] W.A.W. Neilson, "Interjurisdictional Harmonization of Consumer Protection Laws and Administration in Canada," 55 *Collected Research Studies*, 59-115, Royal Commission on Canada's Economic Union (Sept. 1985).

[10] *1988 Report*, p.3.

[11] V. Black, "A Brief Word About Advertising" (1988) 20 *Ottawa Law Review*, 509, 524-25.

[12] Trade Practice Act, R.S.B.C. 1979 c.406 as am., discussed in Edward Belobaba, "Unfair Trade Practices Legislation: Symbolism and Substance in Consumer Protection" (1977), 15 *Osgoode Hall Law Journal* 327.

As we have learned from Mr. Martins's paper, the Marketing Practices Branch accepted the Collins Report "not only (as) a blueprint for reform but (also as) a status report on the effectiveness of the current laws and practices".[13] Preliminary positions on four particular reforms have been staked out by the Branch and consultations with business and consumer groups are continuing. The areas in questions involve remedial orders, interpretive rule-making, AVC's and the non-criminal case adjudication process.

Unlike the earlier phases of reform musings, the present efforts must be given very careful consideration for at least four reasons which may be summarized as follows:

(1) Political Will. The House Committee's Report emanated from an all-parties committee. Its recommendations were unanimous, very specific and sharply focussed. Provided that the Minister can secure some time on the legislative agenda of Cabinet, the prospects for expeditious and favourable consideration by Parliament are positive.

(2) Constitutionality. The April 1989 decisions of the Supreme Court of Canada in *City National Leasing* and *Rocois Construction*[14] greatly strengthen the constitutional capacity of the federal Parliament to enact new marketing practices legislation under the trade and commerce power. In upholding the 1975 civil damage provisions, the Court appears "to give the federal government considerable latitude to enact other competition - based provisions, whether substantive or procedural, to further an integrated market economy of Canada. *Such provisions might include rules with respect to class actions or general provisions relating to marketing practices*"[15] (emphasis added).

(3) Federal-Provincial Relations. In the 1970s, a number of provincial governments (for example, British Columbia, Alberta, Ontario and Quebec) were less than enthusiastic about the prospects for a federal trade practices jurisdiction. Preliminary discussions about concurrent legislative regimes did not go well.[16] It may be suggested that political priorities at the provincial level are now more amenable to accommodation. Certainly at the operational level, the two regimes co-exist quite easily in their present state.

(4) The Familiarity Factor. Notwithstanding the adage that 'familiarity breeds contempt,' the opposite may happen in the case of the House

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[13] Martin, *supra* note 4.

[14] Per note 6, *supra*.

[15] Lawson Hunter, "Canadian Competition Law Developments" in 10 *Canadian Competition Policy Record* (No. 2) 1 (June 1989).

[16] For a fuller account, see Neilson, *supra* note 9.

Committee's recommendations. The deficiencies of a solely criminal law approach to misleading advertising have been chronicled repeatedly in academic, government and professional reports for the past twenty years. The reform objectives of consumer redress, timeliness and cost-effectiveness are unassailable. The debate is over the ingredients not the principles. The cumulative effect of these factors is to tilt the balance in favour of implementation of the thrust of the Committee's reform recommendations.

With this suggestion in mind, we turn to a more detailed examination of these principal reform proposals: Proactive information and education programs; and Administrative Remedies: Injunctive Relief, Corrective Advertising, and Assurances of Voluntary Compliance .

3.0 THE PRINCIPAL REFORM PROPOSALS - SOME DIRECTIONS AND PROGNOSES

A basic premise of the current exercise is its emphasis on increasing the decriminalization of the enforcement framework. In the words of the Bureau,[17] the proposed "framework for reform" does "not propose to widen the scope of the misleading advertising provisions but was, rather confined to allowing improved and more equitable options for dealing with matters that are currently within the ambit of the Act, but are adjudicated by the criminal courts" (emphasis added).

3.1 Enforcement and Education

The Standing Committee's recommendations in this area urged the Director and federal Minister to press ahead with their respective programs to educate consumers and businesses and to co-ordinate enforcement and complaint-handling procedures with their provincial counterparts. A more pro-active preventive role was argued upon the Marketing Practices Branch.[18] As we have seen, steps have been taken in this direction, within available resources, to develop the Program of Advisory Opinions, to establish the Compliance and Co-ordination Branch and to emphasize information and education programs, sometimes in joint ventures with business and consumer groups. Whether a larger, sustained response to the Committee's recommendations is possible within present resource limits is open to question.

3.2 Administrative Remedies

Administrative remedies would complement the Act's present penal sanctions. This is also the prevailing provincial model in trade practices regulations. In the words of the House Committee, "[a]dministrative remedies should be available both in the course of a criminal proceeding and as part of a separate system of remedies which the Director...can draw upon when penal sanctions are deemed to be inappropriate".[19]

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[17] See Martin, *supra*, note 4.

[18] *1988 Report*, pp. 8-9.

Injunctive Relief: The 1976 Trebilcock's study for DCCA identified injunctive and declaratory relief as the "major sanctions contemplated within the model Act," a prediction borne out in the case of the Ontario *Business Practices Act*. The element common to the 1976 Study's proposals, the provincial experience and the 1988 House Committee's Report is the prominent place accorded prohibitory or injunctive orders in the legislative design of modern legislation curbing misleading advertising. An enactment dedicated to the curtailment of deceptive practices requires a clear and prompt power to quickly put an end to such conduct.

Section 34 of the *Competition Act* provides for both injunction and prohibition orders for misleading advertising and offences. While there have been a few cases involving a consent Order of Prohibition,[20] injunctive relief is not readily available under the present evidentary criteria. The 1988 House Committee Report adopted the reasoning of the 1976 Study in this respect in calling for a more available cease and desist remedy directly available to the Director on application to a court for the necessary injunction.[21]

In British Columbia, injunctive relief may be sought from the Supreme Court by the Director of Trade Practices "or any other person whether or not that person has a special, or any, interest...or is affected by a consumer transaction."[22] The relief may be in the form of an interim or permanent injunction or a declaration and may be sought without furnishing security for costs in the case of a private plaintiff suing in a representative capacity. Corrective advertising may be ordered as part of the ancillary relief, as well as the restitution of any payments made by consumers by reasons of the supplier's improper conduct. By section 19 of the same B.C. statute, in any interim injunction application,

> (a) the court shall give greater weight, importance and the balance of convenience to the protection of consumers than to the carrying on of the business of a supplier;
> (b) the director of any other person...shall not be required to post a bond or give an undertaking as to damages; and
> (c) the applicant need not establish that irreparable harm will be done to himself or all other consumers, or any designated class of consumers, in the Province, if the interim injunction is not granted.

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[19] *1988 Report*, p. 19.

[20] See, for example, *Cummins Diesel of Canada Limited*, consent Order of Prohibition (Jan. 17, 1989), cited in 2 *Misleading Advertising Bulletin* 7 (Jan.-Mar.1989).

[21] *1988 Report*, p. 22.

[22] *Trade Practice Act*, R.S.B.C. 1979, c.406, as am., s.18 (1).

It is interesting to note that the 1976 Trebilcock Study[23] favoured the authority of an individual (or class) to apply to the Court for an administrative order (subject to the right of the Director to intervene). An alternative power to apply to the Director to commence an action for a prohibition order and ancillary relief was also supported by the Study. Neither measure to encourage private enforcement was directly mentioned by the 1988 Committee Report (subject to the separate support for class actions). These are perplexing omissions in view of the Committee's concern with limited enforcement resources and their support for private class actions "to obtain redress for the financial loss or damage that may result from misleading advertising."[24]

Corrective Advertising: As an administrative remedy, corrective advertising appealed to the 1976 Study[25] and was adopted in the 1974 B.C. *Trade Practices Act*[26] and the 1975 Alberta *Unfair Trade Practices Act.*[27] The 1988 House Committee characterized it as a "powerful tool" and recommended amendments to the Act to allow a court in both civil and criminal proceedings and also in consent agreements, to order an offender to issue a corrective advertisement.[28]

Corrective advertising is an ancillary remedy, used in conjunction with a cease and desist order, repayment or restitutionary relief and sometimes with criminal sanctions. Thus, the offending advertisement is withdrawn (voluntarily or by order) and the corrective message is substituted. The publicity, in theory, informs the originally misled consumers, restores competition to its pre-offence state and deters others from engaging in similar practices. In practice, the adoption of this remedial sanction will require some considerable legislative planning and consultation. For example, not all deceptive advertisements are appropriate for corrective replacements. Ads with measurable public impact which provide an advantage to the advertiser over time are more amenable to the corrective remedy.

These factors will vary with the frequency and timespan of the advertisement, audience characteristics, the impact on buying behavior and the media employed. Experience suggests that the remedy would be employed principally in the print media (newspapers, magazines, point-of-sale).

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[23] 1976 Study, pp. 320-322.

[24] *1988 Report*, p. 37.

[25] 1976 Study, p.318.

[26] R.S.B.C. 1979, c.406, as am., s.18(1).

[27] R.S.A. 1980, c. U-3, as am; s.17.

[28] *1988 Report*, pp. 23-24.

The administrative experience under section 60(2) of the current *Competition Act* might be relevant here. Under this provision, an advertiser will avoid conviction if, *inter alia*, reasonable steps are taken to publish a correction notice to the audience of the original commercial message. The Act does not otherwise prescribe the content, form or manner for the correction notice. Guidelines published by the Director suggest a series of steps that ought to be taken by advertisers to maximize the possibility of actual notice being received by consumers who saw the original advertisement.

The 1988 House Committee supported the Guidelines' approach but went further and recommended formal regulations under the Act by which Cabinet would "make regulations, prescribing, among other things, the location, size, content, duration and form of correction notices."[29] The regulations, given the experience with the Guidelines and comparable provincial legislation, would need to specify the range of terms available to a court in ordering the publication of correction notices and corrective advertisements. The regulations would also provide the coverage blueprint for any negotiated consent order between the Director and an advertiser. Thus, the matters to be considered in any regulations would include: the choice of medium; the required expenditure; the number, timing, content, wording and placement of the corrective advertisement; the right of prior review by the Director given the accepted objectives of the corrective advertisement; and other terms deemed appropriate in the circumstances.

Consent Procedures - Assurances of Voluntary Compliance: Experience in Canada, the United Kingdom and the United States confirms that the AVC is an essential administrative remedy and enforcement option.[30] Versions of the remedy, in the form of consent Prohibition Orders and Undertakings are already being employed by the Director in appropriate cases. The procedure avoids civil enforcement proceedings and criminal prosecution by permitting the statutory enforcement authority to accept a written undertaking in lieu of other proceedings.

The assurance commits the signing party to comply with the Act (usually by ceasing the impugned activity) and frequently to undertake a series of remedial and corrective steps in favour of affected consumers, competitors or other persons. These steps may include refunds, the modification of sales forms and practices, the completion of promised contracts and the reimbursement of investigation costs to the Director.

For his part, the Director would usually stop his investigation, withdraw any proceedings and allow the trader to continue operations subject to the

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[29] *1988 Report*, p. 48.

[30] See W.A.W. Neilson, "Administrative Remedies: The Canadian Experience with Assurances of Voluntary Compliance in Provincial Trade Practices Legislation" (1981), 19 *Osgoode Hall Law Journal* 153.

AVC. The Assurance, in most cases, is a legal obligation equivalent to a statutory order and remains a matter of public record. The remedy is shaped to the situation at hand, frequently in a manner or form not amenable to judicial creation or supervision.

An AVC is sometimes characterized as a half-way house between an informal warning and a formal judicial proceeding. In practice, an AVC requires the establishment of grounds that would support a civil injunctive proceedings. The measure would seem most appropriate in two situations;

> (1) Where the conduct is not seriously fraudulent and the trader has not been previously condemned for predatory practices...(and)
> (2) In borderline cases where the legality of a trading practice is unclear, undertakings or orders can add refinement to general prescriptions by specifying what is prohibited in the context of the particular trade.[31]

The 1988 Commons Committee Report (and the 1976 Study Report as well) recommended the adoption of the AVC or consent agreement in an amended *Competition Act*. The formal undertakings would become a matter of public record and the advertisers would be required to provide written evidence of compliance with their AVC's.

It is noteworthy that the Commons Committee left the question of an actual enforcement and compliance policy for AVC's to guidelines to be developed by the Director of Investigation and Research.[32] Two problems of administering the AVC remedy were noted. The first concerns the evidence in some jurisdictions that the AVC is used to inflate enforcement statistics with toothless undertakings by offenders who range from the wilful and repetitive to the reckless and oppressive. At the other end is the image of the wild-eyed, overbearing Director combining the role of prosecutor and judge laying "the administration open to charges of blackmailing innocent businessmen into half-hearted AVC's."[33]

Administrative enforcement powers, by their very nature, invite continuing interest in the fairness and appropriateness of their exercise. Our experience with the provincial trade practices statutes and their U.S. and U.K. counterparts confirms this necessity and points to three factors to be considered in designed the AVC Guidelines (one assumes that they would emerge in the form of Governor-in-Council regulations pursuant to an empowering authority in the amended Act):

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[31] Terrence Ison, *Credit Marketing and Consumer Protection* (London: Croom Helm, 1979), at pp. 395-396 referring to the appropriate use of undertakings and prohibitory orders under the U.K. *Fair Trading Act*, 1973.

[32] *1988 Report*, p.26.

[33] Tex Enemark, in Panel Discussion, "Experiences and Issues under Trade Practices Legislation" in Ziegel et al., eds., *Proceedings of the 7th Annual Workshop on Commercial and Consumer Law*, at pp. 11-16, (Oct. 1977) (Toronto: Canada Law Book, 1979).

> (1) The meaning of 'public record' must be clarified , including the possibility of public comment before an AVC formally comes into effect;
> (2) The grounds of 'reasonable belief' for a court enforcement proceeding must be clearly required of the Director prior to the commencement of AVC discussions; and
> (3) The selection and training of enforcement staff with strong negotiation skills and legal analytical strengths should be a matter of high priority.

As I argued on a previous occasion, the litmus test of the AVC remedy "is in the completeness of the Director's preparation, the prior disclosure of the procedures governing the format of, and the time available for, any negotiations and the constant readiness to let the courts settle the matter if negotiations should be unsuccessful."[34] The possible terms of an AVC remedy will be a major element in any federal reform proposal. The provincial experience would support the case for maximizing the flexibility of terms in order that the AVC's may be tailored to the circumstances at hand. Predictable terms would include undertakings to comply with the Act, to reimburse persons affected by the advertiser's conduct and to publish corrective advertisements. The admission of guilt is not a necessary term. But the reimbursement of investigative costs and the divestment of profits derived from the practice to the Crown are terms that might be proposed in the Bureau's 'framework for reform".

What is the penalty for breaching an AVC? In the provincial precedent, the failure to comply with the Undertaking amounts to a statutory offence for which a criminal prosecution would lie in its own right. However, since the party normally did not admit the offence and no proof (certainly in the criminal law sense) has been introduced, it is very questionable whether the advertiser would be convicted of a criminal offence for breaching an AVC *per se*. At the end of the day, it is probably more prudent to predict that the non-compliance with the terms of an AVC will result in a prosecution under the Act's provisions that were breached in the first instance and are most likely being violated again. In this scenario, the Crown would introduce the AVC in speaking to sentence.

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[34] W.A.W. Neilson, "The Enforcement of Consumer Protection Legislation: The Experience with Negotiated Settlements Under Trade Practices Legislation in Canada" (1985) 35 *University of Mexico Law Review* 345 at 351.

4.0 SOME CONCLUDING REMARKS

In addition to the proactive education program and the three administrative remedies just discussed, the Bureau of Competition Policy is considering reform proposals in interpretive rule-making and remedial orders. Consultations are proceeding on both fronts, prompted by the support of the Committee Report.[35]

Interestingly, it does not appear that proposals are being reviewed on two other policy reforms advocated by the Commons Committee. These are substitute actions[36] by the Director on behalf of consumers or a class of aggrieved consumers and class actions[37] by persons who have suffered loss or damage as a result of deceptive marketing practices.

There is little doubt that the 1988 Commons Committee Report has provided a fresh impetus to reform proposals for revamping the Act's marketing practices provisions. Coupled with the strengthened case of constitutional validity for a regulatory framework featuring administrative remedies, the prospects for the first significant legislative reform in nearly fifteen years are substantial. Whether that framework will relate to a separate agency, the Competition Tribunal or the courts in respect of non-criminal enforcement proceedings is a moot point - and beyond the scope of this paper.

Postscript: On January 31, 1991 the Working Group on Amendments to the Misleading Advertising and Deceptive Marketing Practices Provisions of the *Competition Act*, chaired by Ed Ratushny, presented its report, *Effective and Equitable Enforcement*, to the Director of Investigation and Research.

Here is a list of some of the most important recommendations by the Working Group:

1. All of the existing criminal offences related to misleading advertising should be eliminated with the exception of a general prohibition comparable to the existing section 52(1)(a).
5. It should be expressly provided by legislation that non-criminal adjudication is an alternative and not incremental to criminal prosecution.
6. The criminal offences related to misleading advertising should be re-defined to proscribe only deliberate or reckless conduct.

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[35] *1988 Report*, p. 30 (interpretive rulemaking) and p. 41 (restitution).

[36] *1988 Report*, p. 40. The only Canadian precedent for substitute actions is in the B.C. *Trade Practices Act*, R.S.B.C. 1979, c.406, as am., s.24.

[37] *1988 Report*, p. 39. The Government of Ontario announced its intention to introduce class action legislation in the fall of 1989: *Financial Post*, August 28, 1989. Quebec law permits modified class actions. For arguments supporting the case for private enforcement of the Competition Act by permitting a class action remedy, see Andrew Roman, *Consumer Enforcement of Competition Laws* (Ottawa: Public Interest Advocacy Centre, May 1989).

7. The non-criminal prohibitions should not require proof of any mental element but merely the fact of deceptive advertising on a balance of probabilities.
8. The discretion to proceed by way of non-criminal adjudication should be exercised by the Director of Investigation and Research in accordance with published guidelines which are subject to public comment, periodic review and modification.
9. The non-criminal adjudicative process should be characterized by: Speedy Decision-Making; Regional Accessibility; Informality with Fairness; Specialization; and Consistency.
11. The non-criminal adjudication of misleading advertising prohibitions should be conducted by a single judicial member of the Competition Tribunal, sitting at any place in Canada.
19. A "Reference Process" should be established by statute with a view to permitting interpretations of the misleading advertising provisions, and their application, in situations of overriding concern which transcend a specific case and which warrant clarification by the Tribunal.
20. The features of the Reference Process would include the following:
    - (a) References would be heard by a panel consisting of two judges and one lay member of the tribunal;
    - (b) Anyone would be permitted to apply for a reference hearing but hearings would only be ordered by leave of the Tribunal;
    - (c) If leave is granted, public notice of the reference hearing would be required under rule 37 of the *Competition Tribunal Rules* so that intervenors could apply to participate;
    - (d) The reference would be argued on the basis of a set of facts and specific questions similar to a "stated case";
    - (e) In exceptional circumstances, the Tribunal should be authorized to order the payment of costs to ensure that all relevant interests are represented on a reference hearing;
    - (f) Parties to the reference hearing would have the right to appeal pursuant to section 13 of the *Competition Tribunal Act*.
23. The Tribunal should be authorized to make a restitution order provided it can be established that there is: (a) a clearly identifiable individual or group; (b) who has suffered a readily determinable financial loss; (c) which is significant on an individual basis; and (d) which has been caused by the misleading advertising in question.
25. The Tribunal should be authorized to order that an advertiser publish or air an information notice to inform the persons affected of the misleading nature of an earlier advertisement, where:
    - (a) The misleading advertising has adversely affected the marketplace considering (i) the prolonged period of exposure of the advertising and (ii) the substantial adverse effect upon consumers or competitors having regard to the market which was subjected to that advertising; or
    - (b) There has been a breach of a "cease and desist" order or an assurance of voluntary compliance; or
    - (c) There has been an absence of due diligence on the part of the advertiser; or
    - (d) There has been a past criminal conviction for misleading advertising.
26. The *Competition Act* should authorize the Director of Investigation and Research to obtain an Assurance of Voluntary Compliance (AVC) from a party under inquiry.
27. The *Competition Act* should require all AVC's to be filed with the Tribunal and, once filed, they should be enforceable as an order of the Tribunal.
30. Public accountability for the AVC process should continue to occur through public scrutiny of both the guidelines governing the process and the actual agreements which are reached. The current practice of publishing guidelines should continue with the opportunity for public comment, periodic review and modification.

Chapter 19

REGULATION OR COMPETITION: WHERE DO WE GO FROM HERE?

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1.0 INTRODUCTION

In a democratic society there are two types of rules governing economic conduct. Either the market is directly regulated by the government or it is unregulated and the competition or anti-trust laws apply. This is a simple enough concept in economic terms. It is also an important concept. Economic activity can't be subject to two different sets of rules. Which one applies? And who determines which applies? The easiest and most obvious solution would be to have the competition legislation state what activities it applies to.

That, it turns out, is too simple. While Parliament has been prepared to amend the *Competition Act* from time to time over the last century to exempt specific trades and industries - labour unions, fisherman, amateur hockey players - no one wants to address such a fundamental policy issue as the degree to which this legislation applies to regulated industries. Instead, in true Canadian fashion, a regulated industry exemption has developed inadvertently through a series of Court decisions where the issue has nothing to do with public policy or public interest but rather weaving through ancient doctrines of constitutional interpretation.

This paper addresses three issues: What has happened? Why has it happened? Where do we go from here?

2.0 WHAT HAS HAPPENED?

For years, every commentator addressing the interface of competition with regulation was required to tell the story of *Farm Products*[1] and *Canadian Breweries*[2] and to speculate what the result would ultimately be. Now we know. On August 9, 1982 Mr. Justice Estey speaking for a unanimous Supreme Court of Canada delivered his decision in the *Jabour* case,[3] which as Dunlop, McQueen and Trebilcock have commented, left a "yawning gap" in competition law.[4]

More to the point, the *Competition Act* (which came into effect on June 19, 1986) to the surprise of many, ignored the problem. The drive for a new competition law chewed up nine Ministers of Consumer and Corporate Affairs since the Economic Council's Report[5] in July 1969 began the process. It was apparent to the federal government that they had enough problems trying to establish a new Competition Tribunal and new civil procedures for mergers and monopolies without taking on every Provincial Government and their cherished marketing boards and other forms of regulated conduct.

On the centenary of Canada's competition law, it is appropriate to review the history of these developments and speculate where we go from here insofar as the application of competition law as to regulated industries is concerned.

The *Jabour* decision carefully reviewed all of the regulated industry cases that had been decided by the Courts.[6] The main principles relied upon are those that were set down by the Supreme Court of Canada in the *Farm Products Marketing Reference* in 1957.[7] That case arose as a constitutional reference to the Supreme Court of Canada regarding the question whether the Ontario *Farm Products Marketing Act* was valid Provincial legislation given that it authorized the formation of various marketing schemes and supervising agencies, some of which appeared to deal with Federal matters. One argument was that the *Combines Investigation Act* prevented the Ontario legislature from enacting certain aspects of this legislation.

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[1] *Reference Re Farm Products Marketing Act*, [1957] 1 S.C.R. 198.

[2] *R. v. Canadian Breweries Ltd.* [1960] O.R. 601; 126 C.C.C. 133; 33 C.R. 1 (H.C.J.).

[3] *Jabour v. Law Society of British Columbia*, [1982] 2 S.C.R. 307.

[4] Bruce Dunlop, David McQueen and Michael Trebilcock, *Canadian Competition Policy: A Legal and Economic Analysis* (Toronto: Canada Law Book, 1987), p. 293.

[5] Economic Council of Canada, *Interim Report on Competition Policy* (Ottawa: Queen's Printer, 1969).

[6] *R. v. Chung Chuck*, [1929] 1 D.L.R. 756; *Simoneau*, (1935) 65 C.C.C. 19; *Cherry v. R.*, (1937) 69 C.C.C. 219; *Ontario Boy's Wear Ltd. v. The Advisory Committee*, 1944 S.C.R. 349; and *R. v. Canadian Breweries*, [1960] O.R. 601 (H.C.J.).

[7] [1957] 1 S.C.R. 198.

The Court rejected this argument on two grounds. First, the Court noted the long-standing rule of constitutional interpretation which provides that if a Federal statute can be properly interpreted so as not to interfere with a Provincial statute, such interpretation is to be applied in preference to another construction which would bring about a conflict between the two statutes. Accordingly, the Court found that the *Combines Investigation Act* required a finding that the scheme was likely to operate to the detriment or against the interest of the public. If the scheme was being carried out pursuant to valid Provincial law, then surely the Court must assume that the scheme was in the public interest and could not be operating to the detriment of the public. It follows that Parliament could not have intended that the *Combines Investigation Act* should apply (ie. there really was no conflict). This was set out by Mr. Justice Locke in his famous quotation;

> It cannot be said, in my opinion, that within the terms of para. (a)(vi) of s. 2 of the *Combines Investigation Act* the scheme "is likely to operate to the detriment or against the interest of the public, whether consumers, producers or others". Rather it is a scheme the carrying out of which is deemed to be in the public interest. Furthermore, the offence defined by s. 2 which renders a person subject to the penalties prescribed by s. 32 is a crime against the state. I think that to perform an act which the Legislature is empowered to and has authorized cannot be an offence against the state.[8]

The second argument was that s. 32 of the *Combines Investigation Act* was directed towards "voluntary" combinations or agreements. What was at issue in the *Farm Products Marketing Act*, as Mr. Justice Rand pointed out,[9] was coercive as applied to members of the provincially regulated group. In other words, they didn't have any choice. They were required to carry out these activities pursuant to valid Provincial law. On that basis, how could they be liable for entering into an agreement to limit competition in the essence of which was it was a voluntary act?

This last point was developed by Mr. Justice Estey in the *Jabour* case who pointed out that the Benchers of the British Columbia Law Society were not acting voluntarily but were merely discharging their duties pursuant to Provincial statute.[10]

These two principles may however have limited application. First, the anti-conflict theory appears to be based upon the notion that the *Competition*

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[8] [1957] 1 S.C.R. 198 at 239.

[9] The Provincial statute contemplates coercive regulation in which both private and public interests are taken into account. The provisions of the *Combines Investigation Act* and the Criminal Code envisage voluntary combinations or agreements by individuals against the public interest that violate their prohibitions. The public interest in trade regulation is not within the purview of Parliament as an object against which its enactments are directed. *Re Farm Products*, [1957] 1 S.C.R. 198 at 219-20; 7 D.L.R. (2d) at 278.

[10] [1982] 2 S.C.R. 307 at 330.

Act is criminal law. Put differently, while the *Jabour* case appears to have left a "yawning gap", it provides little real guidance in many fact situations. As Mr. Justice Estey states;

> So long as the *Combines Investigation Act* or at least Part V is styled as a criminal prohibition, proceedings in its implementation and enforcement will require a demonstration of some conduct contrary to the public interest. It is this element of the federal legislation that these cases all conclude can be negated by the authority extended by a valid provincial statute.[11]

But what happens where the Courts are considering a civil action under the *Competition Act*? Madame Justice Reed of the Federal Court answered this question in the *Industrial Milk Producers* case.[12] That was a civil action pursuant to S.31.1 (now S.36) of the Act alleging damages as a result of breach of S.32 (now S.45). Madame Justice Reed concluded that while the plaintiffs were suing on the basis of a civil cause of action, this did not remove them from the established jurisprudence because in order to have a civil cause of action under s. 31.1 one must prove the same elements which it is required to prove under s. 32. So far so good. But what happens if it is a proceeding before the Competition Tribunal - abuse of dominance, a prohibition of a merger or a refusal to deal?

Nor does the "voluntary agreement" argument take us very far. That is a neat little argument to remove liability of the regulators such as the Benchers or Marketing Board personnel who are merely "doing their job". But what if the *Jabour* case dealt not with an agreement by the Benchers to restrict advertising but with an agreement of individual law firms to restrict advertising?

This distinction incidentally was pointed out by Mr. Justice Eberle in the *Waterloo Law Association* case.[13] There, members of the Waterloo Law Association were alleged to have implemented a suggested fee tariff. The lawyers sought a declaration that their activities were exempt from the *Competition Act* as the legal profession was regulated by the Law Society of Upper Canada pursuant to valid Ontario law. While Mr. Justice Eberle was not prepared to decide the matter, he did note in passing that there may well be a distinction between the activities of individual lawyers and the activities of the Benchers.

What was unique about the *Jabour* case was how broad the regulatory authorization was. The statute authorized the Benchers to take disciplinary action for any "conduct unbecoming a member of society". The legislature defined "conduct unbecoming" as including "any manner, conduct or thing that is deemed in the judgment of the Benchers to be contrary to the best interests of the public or of the legal profession".

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[11] (1982) 137 D.L.R. (3d) 1 at 37.

[12] *Industrial Milk Producers Association v. Milk Board, Canadian Dairy Commission. et al.*, 1988 21 C.P.R. (3d) 33 (FCTD).

[13] *Waterloo Law Association v. A.G. of Canada*, (1986) 58 0.R. (2d) 275 at 281-2.

There was no explicit authority to regulate advertising. Nor, according to Mr. Justice Estey, was any required. But it is important to notice that "conduct unbecoming" was defined. Mr. Justice Eberle in *Waterloo Law* seized on this distinction. While he chose not to rule on the question of whether any Ontario lawyers were exempt, he did note the difference between the B.C. and Ontario legislation;

> Although s. 34 of the Ontario *Law Society Act* enables the Law Society to discipline and disbar lawyers who are found guilty of professional misconduct or of conduct unbecoming a barrister or solicitor, the Ontario *Act* contains no provision similar to the section 1 definition found in the British Columbia *Act*.[14]

What is the significance of this?

The power to regulate has to be authorized.[15] But there is some limit to how broad and undefined the grant of regulatory power is. The suggestion in *Jabour* is that the power can be as broad and general as the Provincial Legislature wishes. But says Mr. Justice Eberle in *Waterloo Law* however broad - it must be defined in some fashion. This concept should keep competition lawyers busy for at least the next decade if not the next 100 years.

Waterloo Law raises one other uncertainty in this area. The Director takes the position that this is a "defense" rather than an "exemption". The practical consequence of it being a defense is that it can be raised only at trial after lengthy investigation as opposed to being determined as a preliminary matter. This proposition is subject to debate. In fact, in the *Jabour* case, the defendants successfully sought a Declaration that the legislation did not apply to the legal profession rather than having to raise the matters in defense at trial. However, in the *Waterloo Law* case the Supreme Court of Ontario was not prepared to make a decision on a preliminary motion for a Declaration on the ground that all the necessary facts were not before the Court and the matter was not "ripe" for determination.

It is also clear from *Jabour* that the Court is not going to entertain elaborate reviews as to whether the Legislature established a proper regulatory technique;

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[14] *Ibid.*

[15] In *Waterloo Law*, Mr. Justice Eberle stated, "Notwithstanding these three principles, I recognize that a lawyer or law association ought to be able to claim an exemption, in appropriate circumstances, in answer to a prosecution under the *Competition Act*, where the activities which give rise to the prosecution are activities required by the governing body of the profession acting within powers delegated to it by a valid provincial statute. I recognize also that it may be sufficient if the activities are merely authorized, and not actually required." This was approved by the Ontario Court of Appeal in *Regina v. Independent Order of Foresters* where Grange J.A. stated, "there can be no exemption unless there is a direction or at least an authorization to perform the prohibited act" (Unreported judgment, February 7, 1989, emphasis added).

> It is up to the Legislature to determine the administrative technique to be employed in the execution of the policy of its statutes. I see nothing in law pathological about the selection by the Provincial Legislature here of an administrative agency drawn from the sector of the community to be regulated ... It is for the Legislature to weigh and determine all these matters and I see no constitutional consequences necessarily flowing from the regulatory mode adopted by the province in legislation validly enacted within its sovereign sphere as is the case here.[16]

Courts in the future are also not likely to engage in a detailed analysis as to whether the regulatory jurisdiction has been exercised in the proper fashion. This concept comes from a *Canadian Breweries* case where McRuer J stated: "When a provincial legislature has conferred on a Commission or Board the power to regulate industry and fix prices and that power as been exercised, the Court must assume that the power is exercised in the public interest.[17] The problem is that it is often difficult to determine whether the power has been exercised or not. Deliberate non-action can be an effective exercise of regulatory jurisdiction. As Madame Justice Reed observed in the *Industrial Milk Producers* case,[18] "the jurisprudence, in my view, deems actions taken pursuant to Federal or Provincial regulating authorities to be in the public interest."

This, of course, is contrary to U.S. jurisprudence where an implied immunity will not be inferred unless the regulatory scheme is "pervasive". There are a number of U.S. cases where anti-trust exemption or immunity was denied when a Court ruled that the regulatory scheme was not pervasive or extensive enough.[19]

The other basic difference between Canadian and American law with respect to the regulatory exemption is that the American law generally requires that the anti-competitive conduct must be mandated or required[20] and not simply authorized which is sufficient for the Canadian exemption.

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[16] [1982] 2 S.C.R. 307 at 334 (emphasis added).

[17] [1960] O.R. 601 at 629.

[18] *Supra*, Note 12.

[19] E.g., *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973) (congressional rejection of comprehensive regulatory scheme for electric industry supports rejection of anti-trust exemption claim); *States v. Philadelphia National Bank*, 374 U.S. 321, 352 (1963) (regulation not pervasive; agency approval does not immunize merger); RCA case, note 6 (FCC control of television not pervasive; agency approval does not immunize exchange of stations); *United States v. Borden Co.*, 308 U.S. 188 (1939) (Agriculture Secretary' s regulation of milk industry not pervasive; no immunity); *Inter City Oil Co. v. Murphy Oil Corp.*, 1976 Trade Case. 60948 (D. Minn.) (Federal Energy Administration regulation of petroleum marketing not pervasive).

There is one final point which may further serve to confuse the issue. In 1986 when the *Competition Act* came into effect, it contained s. 2.1 to clarify that the Act applies to federal and provincial Crown agencies;

> This Act is binding on and applies to an agent of Her Majesty in the right of Canada or a province that is a corporation, in respect of commercial activities engaged in by the corporation in competition, whether actual or potential, with other persons to the extent that it would apply if the agent were not an agent of Her Majesty.

In the *Industrial Milk* case, the plaintiff attempted to argue that the *Jabour* case should be distinguished because this section had been introduced after *Jabour* and the section made it clear that the defendant Marketing Boards and the Canadian Dairy Commission were subject to the *Competition Act*. This argument was rejected by the Federal Court on the basis that the anticompetitive practices at issue were "regulatory" and not "commercial" activities. Accordingly, the Court struck the plaintiff's Statement of Claim as it disclosed no cause of action. That may, in fact, be a tenuous argument and this issue will likely continue to be debated.

3.0 THE LAW REFORM EFFORT

With all this confusion emanating from the Courts, it is surprising that there hasn't been more guidance on the legislative front. This is not a new issue. The reform of Canada's competition law began with the Report of Economic Council of Canada in 1969. To be fair to the government, the Council was a bit vague on this issue, but, there were some general statements: "The hidden costs to the economy of poor regulatory performance provide, in our view, a strong justification for applying the underlying principles of competition policy, in suitably modified form, to the regulated sector of the economy."[21]

It wasn't clear, of course, what that "modified" form was or what steps would be taken to ensure that these principles of competition policy would be applied. Equally vague was the recommendation that "It would be logical for the Department of Consumer and Corporate Affairs to be called upon for its views whenever economically important regulatory policies are being formulated or reviewed within the Federal Government."[22]

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[20] *Goldtarb v. Virginia State Bar*, (1975) 421 U.S. 773 at 790: "The threshold inquiry in determining if any competitive activity is a state action of the type the *Sherman Act* was not meant to proscribe is whether the activity is required by the state acting as sovereign. Here we need not enquire any further into the state action in question because it cannot be fairly said that the State of Virginia, through the Supreme Court rules, required the anti-competitive action by either respondent ... The fact that the State Bar is a state agency for some limited purpose does not create an anti-trust shield that allows it to foster anticompetitive practices for the benefit of its members." This principle was specifically argued by the Crown in *Jabour* and rejected by the Court, (1982) 137 D.L.R. (3d) 1 at 42.

[21] Economic Council of Canada *Interim Report on Competition Policy* (Ottawa: Queen's Printer, 1969) p. 160.

However, when Mr. Basford introduced to the proposed legislation in 1971 in the form of Bill C-256, the issue was tackled directly.[23] Section 92 of that Bill provided a regulatory exemption for conduct expressly required or authorized by Federal, Provincial or Municipal law. To qualify such conduct must be "expressly required to be supervised and regulated on a continuing basis by a Board, Commission or other public body appointed pursuant to the legislation" and the public body must be "charged with the duty of protecting the public interest."

Bill C-256 faced a painful death under a hail of criticism that established the high level of noise and debate that was to follow in the next 20 years.[24] In an attempt to reduce the law reform effort to bite-size chunks, the Government agreed to proceed in two phases. Phase I was ultimately enacted in 1976 and Phase II, a decade later in 1986.

With the death of Bill C-256, the Government decided to pave the path for Stage I with the Skeoch-McDonald Report. It was the first study to highlight in definitive terms the problem of the regulatory exemption.

> Action to deal with monopolies operating under government authorization or supervision impresses us as being of at least equal urgency to that required in the private sector...
>
> (1) the restrictive conduct is specifically imposed by the legislation; and
>
> (2) the restrictive conduct is actively supervised by independent officials and not by representatives of the participants;
>
> (3) the restraint is necessary to the effective accomplishment of the legislative goal and is the least restrictive means available to achieve the legislative goal.
>
> Indeed, we recommend that these three principles apply to all forms of monopoly control authorized by Government. In particular, we are persuaded that they are necessary in the case of so-called "supply management" marketing boards. These organizations are, in reality, nothing more than cartels.[25]

Bill C-42, which was introduced in March of 1977 contained a regulatory exemption clause in the form recommended by Skeoch-McDonald. The clause exempted conduct, expressly required or authorized by a public agency (federal or provincial) if the members of that agency were not appointed or elected by representatives of the persons whose conduct was being regulated and the application of the competition legislation would seriously interfere with the primary objectives of the agency's regulatory mandate.[26] This covered all the bases and reflected a number of principles in vogue in American jurisprudence at the time. Its implications for Donald Jabour and the B.C. Benchers were obvious.

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[22] *Ibid.*, p. 171.

[23] Bill C-256, *The Competition Act*, First reading June 29, 1971 (Ottawa: Queen's Printer).

[24] See W.T. Stanbury, *Business Interests and the Reform of Canadian Competition Policy, 1971-1975* (Toronto: Carswell/Methuen, 1977).

[25] L.A. Skeoch with Bruce C. McDonald, *Dynamic Change and Accountability in a Canadian Market Economy* (Ottawa: Minister of Supply and Services Canada, 1976), pp. 151-152.

Bill C-42 also died on the Order paper to be replaced by Bill C-13 in November of 1977. This legislation also contained a regulatory industry defence similar to that included in Bill C-42 although it was softened a bit.[27] Like its predecessor, Bill C-13 was never enacted. This was the last we saw of an attempt to define in the statute the extent to which regulated activity was subject to competition legislation. This was one of the major issues in the twenty year debate to reform Canada's competition laws. Why did it drop off the table?

There are a number of reasons. First, the regulatory exemption threw up a very real political problem. Various provinces had enacted regulatory statutes on the basis of the Supreme Court's 1957 decision in *Farm Products* and believed that their legislation could not be challenged under the federal competition laws. The regulated conduct exemptions included in Bill C-13 (November 1977) and Bill C-42 (March of 1977) would have required most regulatory legislation to have been redrafted.

There is one other possible reason and that relates to the Government's successful introduction of a regulatory intervention in the 1976 amendments. Section 27.1 of the *Combines Investigation Act* provided that the Director was empowered to intervene before any federal regulatory tribunal. The Director began to immediately use this power in the telecommunication area starting with the hearing before the CRTC in 1977 concerning the approval of an agreement whereby Telesat Canada would become a member of the Trans-Canada Telephone System (now Telecom Canada). The terms of the agreement gave the nine-member telephone companies of TCTS control over Canada's sole domestic communication satellite. The Director argued that satellites were a competitive alternative to the telephone company's land line communication network and the agreement would therefore limit competition.

The Commission agreed with this position[28] although the Commission's decision was reversed on appeal to the federal Cabinet.[29] It was an important case and the Director made a major contribution. A number of other cases in the telecommunication industries followed in short order.[30] Subsequently, the Director went on to develop similar expertise in transportation and other related matters.

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[26] Department of Consumer and Corporate Affairs, *Proposals for a New Competition Policy for Canada, Second Stage* (Ottawa: Minister of Supply and Services Canada, 1977).

[27] See Gordon E. Kaiser, "Competition Law and the Regulated Sector" in J.R.S. Prichard et al. (eds.) *Canadian Competition Policy* (Toronto: Butterworths, 1979), Ch. 14.

[28] *Telesat Canada, Proposed Agreement with Trans Canada Telephone System*, Telecom Decision CRTC 77-10, 3 CRT 265 (24 August 1977).

[29] P.C. 1977 - 3152.

As enthusiasm developed, the Bureau of Competition Policy developed a separate division to manage this new activity. Activities were extended to provincial agencies until two Maritime telephone companies persuaded the Courts that the Director was exceeding his statutory jurisdiction by intervening before Provincial agencies.[31] By the time the Supreme Court of Canada upheld the ruling, the Director had managed to have the legislation amended to specifically empower the Director to intervene in provincial proceedings.[32]

It appears that the Director concluded that the way to introduce competition principles into the regulated sector was to intervene directly in regulatory proceedings as opposed to attempting to apply the legislation to industry participants. (See Table 1 and the paper by Monteiro in Part 7 of this volume.)

4.0 FUTURE PROSPECTS

What have we learned in the last twenty years? First, we know that *Jabour* raises as many questions as it answers. The case provides little guidance. This is not surprising. How could a Court resolve a fundamental policy problem by juggling principles of constitutional interpretation. Second, the regulatory intervention has been more successful than predicted. This is a pleasant surprise but is no substitute for clear boundary lines between competition law and regulation. Interventions are limited to those cases where the regulator has decided to initiate a proceeding. The real problem concerns anti-competitive conduct that the regulator is not aware of or is not prepared to deal with. While this may not be a problem for the Director, it is increasingly a problem for private parties. Now that the constitutional hurdle to private actions is gone, it would be nice to have a clear demarcation regarding jurisdiction.

A careful analysis of *Jabour* reveals no clear winners or losers. Everyone is confused and uncertain as to what the next ruling will bring. This process has been continuing since at least 1957. It's time for another attempt at a statutory definition.

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[30] These are summarized in Gordon E. Kaiser, "Competition in Telecommunications Refusals To Supply Facilities by Regulated Common Carriers," (1981) 13 *Ottawa Law Review*, 95.

[31] *Hunter v. New Brunswick (Board of Utilities)* (1988) 20 C.P.R. (3d) 33 (S.C.C.); *Newfoundland Telephone Co. v. TAS Communications Ltd.*, (1988) 20 C.P.R. (2d) 10 (S.C.C.).

[32] See S.126 of the *Competition Act*, R.S.C. 1985, c. C-34.

Table 1

INTERVENTIONS BY THE DIRECTOR OF INVESTIGATION AND RESEARCH BEFORE REGULATORY BODIES, 1975/76 TO 1989/90

Fiscal Year	Federal Regulatory Bodies	Provincial Regulatory Bodies	Total
1975/76	0	0	0
1976/77	3	1	4
1977/78	4	1	5
1978/79	0	2	2
1979/80	3	1	4
1980/81	4	0	4
1981/82	6	9	15
1982/83	4	7	11
1983/84	15	8	23
1984/85	17	6	23
1985/86	15	7	22
1986/87	8	10	18
1987/88	7	9	16
1988/89	6	3	9
1989/90	5	5	10

Source: Director of Investigation and Research, *Annual Report*, 1984/85 and 1989/90.

Chapter 20

WHITHER THE REGULATED CONDUCT DEFENCE?

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1.0 INTRODUCTION

Although the *Competition Act* of 1986 contains a number of specific exemptions for activities which would otherwise be subject to prohibition, there is no general statutory exemption for anticompetitive conduct arising in the regulated domain. Instead, there has emerged from the case law, albeit in still less than fully articulated form, a defence to the Act's criminal (and possibly civil) provisions in circumstances where the impugned conduct is subject to regulation.

The basic principle underlying the regulated conduct defence is that where an activity is authorized or compelled by validly enacted legislation, or regulations promulgated and enforced thereunder, persons engaged in the specified activity should be afforded immunity from prosecution or liability under the Act, as the activity must be presumed to be in the public interest.

2.0 EARLY CANADIAN JURISPRUDENCE

The genesis of the regulated conduct defence is to be found in a number of early cases dealing with the constitutional validity of provincially enacted agricultural price and output maintenance schemes.[1]

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[1] See, for example, *Gibbons v. Metcalfe* (1905), 15 Man. R. 560, 1 W.L.R. 139 (C.A.); *R. v. Chung Chuck*, [1929] 1 W.W.R. 394, [1929] 1 D.L.R. 756, 51 C.C.C. 260 (B.C.C.A.), aff'd [1930] 2 D.L.R. 97, [1930] 1 W.W.R. 129, 53 C.C.C. 14, [1930] A.C. 244 (P.C.); *Rex v. Simoneau* [1936] 1 D.L.R. 143, 65 C.C.C. 19 (Que. Ct. Sess.); *R. v. Cherry* [1938] 1 W.W.R. 12, [1938] 1 D.L.R. 156, 69 C.C.C. 219 (Sask. C.A.); and *Reference Re: Farm Products Marketing Act*, [1957] 1 S.C.R. 198,

The issue confronting the courts in these cases, in light of the constitutional competence of the provinces to deal with matters of property and civil rights within their territorial boundaries, was how to resolve the conflict between federal anticombines legislation, the purpose of which was to promote competition, and the inherently anticompetitive effect of provincially enacted agricultural marketing schemes. It was not until the decision of the Supreme Court of Canada in the *Reference Re Farm Products Marketing Act*, that a reasonably well articulated rationale for this result was developed.

The *Farm Products* case, in fact, offered at least two distinct reasons for holding the price-fixing activities of a provincial marketing agency not to be in violation of the federal statute. The first may be referred to as the "public interest" argument, and was best expressed in the judgment of Locke, J.:

> In my opinion, neither the provisions of the *Combines Investigation Act*, R.S.C. 1952, c. 314 nor of S. 411 of the *Criminal Code*, 1953-54 (Can.), c. 51, are objections to the schemes in question to the extent that they are within the powers which may be validly granted by the Legislature under the terms of the *British North America Act*. It cannot be said, in my opinion, that within the terms of para. (a)(vi) of s. 2 of the *Combines Investigation Act* the scheme "is likely to operate to the detriment or against the interest of the public, whether consumers, producers or others." Rather it is a scheme the carrying out of which is deemed to be in the public interest. Furthermore, the offence defined by s. 2, which renders a person subject to the penalties prescribed by s. 32 is a crime against the state. I think that to perform an act which the Legislature is empowered to and has authorized cannot be an offence against the state.[2]

The view was echoed in the separate concurring judgment of Chief Justice Kerwin, wherein his Lordship stated:

> With respect to [the *Combines Investigation Act*] and also to the sections of the *Criminal Code* referred to, it cannot be said that any scheme otherwise within the authority of the Legislature is against the public interest when the Legislature is seized of the power and, indeed, the obligation to take care of that interest in the Province.[3]

Together, these two judgments may be said to stand for the proposition that where market conduct is regulated pursuant to validly enacted provincial legislation, such conduct must be presumed to be in the public interest and, hence, cannot be taken to offend federal competition law and the public interest protected thereunder.

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7 D.L.R. (2d) 257. (See also, in a different context, *Ontario Boys' Wear Limited et al. v. The Advisory Committee et al.* [1944] S.C.R. 349; and *Tolton Mfg. Co. Ltd. v. Advisory Committee* [1944] S.C.R. 349.)

[2] [1957] 1 S.C.R. 198 at 239.

[3] [1957] 1 S.C.R. 198 at p. 206.

The difficulty with this "public interest" justification for the regulated conduct defence, however, is that all statutes are presumably enacted in the public interest. To suggest that conflicts between the federal *Competition Act* and provincial legislation be resolved on the basis that the provincial statute directly addresses a matter of public interest within provincial jurisdiction is really no more than an assertion of provincial paramountcy with respect to the activity in question. Moreover, this reasoning provides little assistance in those circumstances where both conflicting statutes are federally enacted. Indeed, in this latter situation, the courts would either have to interpret the two statutes so as to eliminate the apparent conflict between them (by holding, for example, that the conduct authorized in one statute was not of the variety sought to be prohibited in the other), or at the very least reconcile them in such a manner as to minimize the scope of the apparent conflict.

A different statement of the principle underlying the regulated conduct defence, and one consistent with the two alternative approaches to resolving statutory conflicts referred to above, was that provided in the judgment of Rand, J.:

> The Provincial statute contemplates coercive regulation in which both private and public interests are taken into account. The provisions of the *Combines Investigation Act* and the *Criminal Code* envisage voluntary combinations or agreements by individuals against the public interest that violate their prohibitions.[4]

In the approach taken by Mr. Justice Rand the impugned acts, though anticompetitive in nature, were the product of state coercion (whether by way of regulation or some other form of legal compulsion). Since there was no voluntariness involved, there was no basis for prosecution under federal competition law.

The first Canadian case to deal with the regulated conduct defence in the context of a criminal prosecution under the *Combines Investigation Act* rather than in the context of a constitutional dispute was *R. v. Canadian Breweries Ltd.*.[5] The accused in that case had been charged under the merger and monopoly provisions of the Act with seeking to "eliminate all substantial competition," including price competition, in the beer industry, by pursuing an aggressive merger policy. The evidence indicated that from 1930 to 1953 the accused had acquired control over 23 rival breweries and in the process had raised its overall share of the Ontario market from 11% to 61%.

The position taken by the defence was that the absence of price competition and difficulties encountered by firms wishing to enter the industry were unrelated to the accused's corporate acquisitions. Instead, it was contended that the observed lessening of competition among industry participants was the direct result of "restrictions... validly imposed by government authorities." The defence also argued that those elements of market conduct unaffected by regulation continued to be subject to vigorous competition.

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[4] [1957] 1 S.C.R. 198 at 219-220.

[5] [1960] O.R. 601 (Ont. H.C.).

Chief Justice McRuer defined the parameters of the regulated conduct defence in the following terms:

> When a provincial legislature has conferred on a commission or board the power to regulate an industry and fix prices, and the power has been exercised, the Court must assume that the power is exercised in the public interest. In such cases, in order to succeed in a prosecution laid under the Act with respect to the operation of a combine, I think it must be shown that the combine has operated, or is likely to operate, so as to hinder or prevent the provincial body from effectively exercising the powers given to it to protect the public interest. If the evidence shows that by reason of a merger the accused is given a substantial monopoly in the market, this onus, in my opinion, would be discharged.
>
> There may, however, be areas of competition in the market that are not affected by the exercise of the powers conferred on the provincial body in which restraints on competition may render the operations of the combine illegal.[6]

Applying the law to the facts of this case, McRuer, C.J.C. acquitted the accused on the basis that the Liquor Control Board of Ontario actively exercised its jurisdiction at all relevant times by fixing the price of beer, vigorously policing instances of price-cutting, and controlling entry into the industry through its licensing powers. In addition, the accused's corporate acquisitions did not confer upon it such a degree of market control as to render the regulator incapable of protecting the public interest through the exercise of its statutory powers. With respect to those market activities not affected by provincial regulation, including product quality, taste, services and packaging, his Lordship found that competition among industry participants was "without restraint."

Although various commentators are less than unanimous on this point, the *Canadian Breweries* case would appear to stand for the following four propositions. First, in order for the regulated conduct defence to apply, an industry must be subject to regulation pursuant to validly enacted legislation. (Note that in this case, there was no dispute at trial as to the constitutional validity of the provincial legislation authorizing the regulation of the brewing industry.) Second, the defence is limited to those activities or types of conduct specifically subject to regulation.[7] Third, it is not enough that the regulatory body merely possess the authority to control the activity or conduct in question. Unless such authority is exercised, the defence will not apply. (Although *Re Farm Products* was not considered by the Court in *Canadian Breweries*, this third proposition is entirely consistent with the distinction between voluntary and coerced conduct made by Mr. Justice Rand in that case.) Fourth, in certain situations, the defence may still be unavailable notwithstanding that the activity in question is subject to active regulatory oversight. Specifically, where the accused has achieved "substantial monopoly in the market" or, has utilized its market power to hinder or prevent the regulatory authority from protecting the public interest through the exercise of its statutory powers, the defence may be of no avail.

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[6] [1960] O.R. 601 at p. 629.

[7] This point, in particular, has been stressed by successive Directors of Investigation and Research. See for example, the various citations in C.J.M. Flavell, *Canadian Competition Law* (Toronto: McGraw Hill Ryerson Limited, 1979) at pp. 48-50. See also Calvin S. Goldman, "The Competition Act as it Relates to the Regulated Sector," Notes for an Address to the Canadian Association of Members of Public Utilities Tribunals, Saskatoon, September 10, 1986, at p. 23.

Finally, it is important to note the actual basis of this decision. The Court rendered a not guilty verdict with respect to the merger charges not because the accused's corporate acquisitions were authorized or sanctioned by the provincial regulatory board, or even because industry prices were regulated as such. Rather, the accused was acquitted on the ground that the observed lessening of competition in the industry was the result of provincial regulation, and not the accused's merger activities.[8]

The issue of the regulator's ability to protect the public interest notwithstanding the accused's non-regulated conduct was also addressed by the Ontario Court of Appeal in *R. v. Lorne Wilson Transport Ltd.*.[9] In affirming the guilt of the accused on charges of bid-rigging tenders for school transportation services, the Court held that the regulatory statute in question did not preclude the operation of the *Combines Investigation Act*, since "the existence of a bid-rigging arrangement would prevent the appropriate authority from effectively exercising the power given to protect the public interest" under the relevant legislation.

3.0 THE JABOUR DECISION

In *A.G. of Canada et al. v. Law Society of British Columbia*[10] (the *Jabour* case), the Supreme Court of Canada considered the regulated conduct defence in a case dealing with whether S.32 of the *Combines Investigation Act* (now S.45 of the *Competition Act*) applied to the actions of the Benchers of the Law Society of British Columbia in instituting disciplinary proceedings against a lawyer who had advertised his fee schedule. During the relevant period there were no provincial regulations or express statutory restrictions barring the type of advertising engaged in by the complainant lawyer, D.E. Jabour, although the Professional Conduct Handbook did enjoin such advertising.

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[8] See, B.S. Romaniuk and H.N. Janisch, "Competition in Telecommunications: Who Polices the Transition? (1986) 18 *Ottawa Law Review* 561 at 638-40.

[9] (1982) 40 O.R. (2d) 86; 138 D.L.R. (3d) 690.

[10] [1982] 5 W.W.R. 289; [1982] 2 S.C.R. 307. Generally, see W.T. Stanbury, "Provincial Regulation and Federal Competition Policy: The Jabour Case," (1983) 3 *Windsor Yearbook of Access to Justice* 291.

The Law Society took the position that its actions were authorized by the *Legal Professions Act*, R.S.B.C. 1960, c. 214, the relevant provisions of which granted the Society the power to discipline lawyers "for conduct unbecoming a member of the Society." The Supreme Court of Canada unanimously accepted the argument that the Benchers had acted pursuant to validly enacted legislation, notwithstanding that the relevant statute nowhere expressly conferred upon the Law Society the power to regulate promotional advertising by lawyers.

The Court also addressed the question whether the conduct of the Benchers came within the prohibition of S.45 of the Act. The Supreme Court concluded that it did not, on the basis that conduct engaged in pursuant to validly enacted legislation, which must be presumed to be in the public interest, cannot be "undue" within the meaning of S.45 and, therefore, cannot be criminal. The Court further concluded that, in disciplining Jabour, the Benchers were discharging a positive duty or mandate under the provincial statute, rather than acting solely of their own accord.

The Court did point out, however, that while the defence was available in the circumstances of this case, neither the Benchers, nor the Law Society, nor the legal profession as a whole, were to be taken to be generally exempt from the provisions of the *Combines Investigation Act* merely because certain of their professional activities were subject to regulation.

> The operative words at the beginning of s. 32 [now s. 45] are: "Every one who conspires, combines, agrees or arranges with another person." These words are broad enough to include all the Benchers acting as a group or individually or the Law Society as a corporate entity and any one or more of the Benchers or of its statutory officers, or indeed any one with whom the Law Society may have acted jointly. Consequently if any two of these persons, natural or legal, voluntarily entered into an agreement condemned by the [*Combines Investigation Act*], the offence would be constituted.[11]

It follows from *Jabour* and the earlier case law that the regulated conduct defence will be available to individuals, companies, and regulatory agencies themselves, in industries subject to regulation, provided the conduct in question is mandated, required, or authorized by validly enacted legislation or regulations enforced thereunder. Absent such legislative leave or compulsion, the defence may not be available.

Left unclear by *Jabour* (which was concerned with the conduct of a regulatory body) is the availability of the defence to individuals or firms in regulated industries in which the regulator's exercise of its statutory jurisdiction over the conduct in question is less than active or patently vigilant. As one commentator has noted, "it may prove difficult to determine whether [a] power has been actually or effectively exercised. Deliberate non-action can constitute both actual and effective exercise of regulatory jurisdiction."[12] Insofar as regulated industries are concerned, therefore, while active regulatory oversight or control of the impugned conduct may be sufficient, it does not appear to be a necessary condition for the defence to apply.

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[11] [1982] 2 S.C.R. 307 at p. 354.

4.0 RECENT CANADIAN CASE LAW

Only a handful of cases decided after *Jabour* have dealt with the regulated conduct defence to any great extent. Of these, perhaps the most interesting is *R. v. The Independent Order of Foresters.*[13] The Independent Order of Foresters (IOF) was charged under S.36 (now S.52) of the Act on 15 counts of false or misleading advertising. The ads in question were directed at the recruitment of life insurance salespersons. The accused successfully advanced the argument at trial that because the life insurance industry was provincially regulated its conduct could not be subject to prosecution under the *Combines Investigation Act*.

Whealy, J. summarized the regulated conduct defence in the following terms:

> What the doctrine really means is that where an industry is regulated by a public authority, and in this case the insurance industry is regulated by the Superintendent of Insurance in the Province of Ontario, then the protection of the public interest is not left to the proscriptions of the *Combines Investigation Act*, but rather is protected by the very public authority doing the regulating.[14]

Evidently, the court was of the view that once an industry is affected by regulation, whatever its nature and degree, firms within that industry are automatically cloaked with immunity from prosecution under federal competition law.

This ground for acquitting the accused was dismissed on appeal by the Crown to the Ontario Court of Appeal. Speaking for a unanimous Court, Grange, J.A., stated that:

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[12] G.E. Kaiser, "Federal Competition Law and the Professions: Problems of Jurisdiction," in P. Slayton and M.J. Trebilcock, eds. *The Professions and Public Policy* (Toronto: University of Toronto Press, 1978) 46 at 50.

[13] District Court of Ontario, January 1987, unreported; affirmed on narrower grounds, Ontario Court of Appeal, February 7, 1989, unreported.

[14] District Court of Ontario, January 1987, unreported.

> The doctrine simply means that a person obeying a valid provincial statute may, in certain circumstances, be exempted from the provisions of a valid federal statute. But there can be no exemption unless there is a direction or at least an authorization to perform the prohibited act.[15]

Since there was "no suggestion in the case at bar that the *Insurance Act* authorizes, much less directs, I.O.F. to give false or misleading representations or to make any representations that might be deemed false or misleading, to the public" the Court rejected the trial judge's finding that the conduct in question was immune from prosecution under the *Competition Act*. The Court also cited with approval the discussion of the regulated conduct defence found in *Waterloo Law Association et al. v. A.G. of Canada*,[16] a case dealing with the applicability of S.45 to the actions of members of a county law association in establishing and adhering to a uniform fee schedule.

Three other recent cases also bear mention. In *R. v. B.C. Fruit Growers Association et al.*,[17] several British Columbia Fruit Growers' Associations were charged with conspiring to limit unduly the facilities for storing or dealing in tree fruit in the Okanagan Valley. Under legislation in force from 1960 onwards, a central selling agency (the "Agency") was declared to be the sole lawful marketing enterprise for B.C. tree fruit, excluding expressly exempted roadside sales booths and certain other sales operations undertaken by individual growers. Rising costs in the administration of the central marketing scheme, however, eventually led a number of growers to pressure the government to allow them to sell their produce independently, which independent sales were permitted by the regulatory Board in 1974. Thereafter, a third class of growers, known as "peddlers," began to emerge. These growers neither opted entirely out of the central marketing scheme nor remained totally within it. They sold some of their produce independently but remained Association members under contract to one of the major packing houses, which meant that the remainder of their crop would be sold through the Agency. This left the Agency and packing houses with lower volumes against which to spread their overheads, and raised per unit marketing costs for growers remaining entirely within the program.

The industry was not long in responding to the perceived problem with "peddlers" and independents. In 1976 the Association, the Agency, various shippers and the packing houses agreed to close all packing and storage facilities to all but Association members marketing their entire crop through the Agency. Independent growers could either build or lease their own facilities or rejoin the Association and adhere to its restrictive marketing policy.

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[15] Ontario Court of Appeal, February 7, 1989, unreported.

[16] (1986) 58 O.R. (2d) 275.

[17] (1985) 11 C.P.R. (3d) 183.

The only issue at trial was whether the withholding of storage and related facilities had been undue. After determining that what the Act sought to protect was the "public interest in free competition," Davies, J. concluded that no undue lessening of storage facilities had taken place. Among the reasons given by the Court in arriving at this result was that the restrictions were necessary for the efficient operation of the industry. The court held, however, that had the lessening of competition been undue the regulated conduct defence would have been unavailable to the accused since the relevant legislation nowhere authorized the foreclosure of packing and storage facilities to independent fruit growers.

In *The Queen v. Canada Packers Inc. et al.*[18] the Crown had sought to prove that the two accused meat packers had conspired to fix prices and allocate markets for the purchase, sale and supply of live slaughter animals and pork cuts and pork products. During the trial one of the two accused pleaded guilty on two of the charges and was convicted. The principal issue at trial was whether the remaining accused had reached an agreement with the other alleged but unindicted co-conspirators with respect to the subject matter of the charges. There was little dispute at trial that the accused had communicated with other meat packers with respect to the fixing of prices and sharing of markets. Literally countless meetings and telephone conversations were found to have taken place over the span of several years. There was even evidence of competitors registering complaints with their rivals for making purchases above established price ranges or in amounts beyond targetted market shares. At the same time, however, while the evidence of market share stability was somewhat ambiguous, it was clear that uniform pricing for different products was not achieved. To the contrary, price volatility, with episodes of vigorous price-cutting, appeared to be the rule. In the result, Lomas, J. acquitted Canada Packers Inc. on the ground that no agreement had been proven. But he also stated that, had an illegal agreement been concluded by the accused, the fact that the industry was subject to regulation would have been no defence.

The *Industrial Milk Producers Association et al. v. Milk Board*[19] involved a civil action pursuant to S.31.1 of the Act (now S.36) to recover damages allegedly suffered by the plaintiffs as a result of conduct by the defendants contrary to S.45 of the Act. The basic complaint was that the various milk production and marketing programs administered by the defendants pursuant to federal and provincial legislation, were contrary to the scheme of the post-1986 *Competition Act* and that the plaintiff milk producers were therefore entitled to compensation for losses suffered as a result of their being denied milk production quotas by the defendants. In granting motions brought by each of the defendants to strike out the statement of claim as disclosing no reasonable cause of action, Madame Justice Reed stated that: "(I)t is not merely agency activity required by legislation which is exempt from operation of the *Competition Act* but also activity which is authorized by such legislation," [emphasis in original].[20]

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[18] Alta. Q.B., January 15, 1988, unreported.

[19] (1988) 47 D.L.R. (4th) 710 (F.C.T.D.).

In arriving at this conclusion the court affirmed, in the clearest possible terms, that mere statutory authorization will suffice as a complete defence to activities or conduct which would otherwise contravene the *Competition Act*. Perhaps more significant still is the fact that Madame Justice Reed in no way limited the potential availability of the regulated conduct defence to S.45 of the Act. Pending further jurisprudence clarifying the full extent of this defence, therefore, it remains an open question whether this defence applies to other types of criminal conduct under the Act, or to reviewable practices before the Tribunal.

Madame Justice Reed warned, however, that even in a proper case the defence was not without limits: "If individuals involved in the regulation of a market situation use their statutory authority as a spring board (or disguise) to engage in anti-competitive practices beyond what is authorized by the relevant regulatory statutes then such individuals will be in breach of the *Competition Act*."[21]

The court's findings in the *Milk Board* case, as well as the implications stemming therefrom, were echoed in an address by the Deputy Director of Investigation and Research (Resources and Manufacturing).

> Generally, the jurisprudence has held that activities specifically authorized by statute or effectively regulated by a public agency will not be found to be in contravention of the *Competition Act*. This is known as the "regulated conduct defence" and it should be viewed as such and not as a blanket exemption from the Act. It is a defence which is activity- or conduct-specific which should not be taken as a defence of all types of behaviour in the industry. In light of the new non-criminal provisions of the Act, the question is raised whether the application of the regulated conduct defence differs in this non-criminal context.[22]

5.0 U.S. LAW

The Canadian regulated conduct defence appears to be considerably broader than its counterpart in the United States. The leading U.S. case in this area is *Parker v. Brown*,[23] where it was held that the *Sherman Act* prohibition of combinations or conspiracies in restraint of trade does not prohibit the states from imposing restraints on competition. *Parker v. Brown* involved an unsuccessful attempt by a raisin producer to enjoin the enforcement of California legislation that established a program to restrict competition among raising growers and to maintain raisin prices to packers.

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[20] (1988) 47 D.L.R. (4th) 710 (F.C.T.D.) at p. 727.

[21] *Ibid.*, at p. 726.

[22] Speech to the Quebec Dairy Industry, Quebec City, November 1, 1988.

At its simplest, the state action doctrine requires that for conduct to be immune from federal antitrust law it must be "compelled by the direction of the State acting as a sovereign": *Goldfarb v. Virginia State Bar*.[24] The defence has been held to apply equally to regulatory authorities and to market participants in regulated industries: *Southern Motor Carriers Rate Conference, Inc. v. United States*.[25]

Apart from conduct that is actually compelled by a state, the state action doctrine only benefits a private party where it can be shown that (1) the restraint is "clearly articulated and affirmatively expressed as state policy," and (2) the conduct in question is "actively supervised by the State itself": *California Retail Liquor Dealers Association v. Midcal Aluminum*[26]; and *Bates v. State Bar of Arizona*.[27] Active supervision requires that a state official (or agency) "has and exercises ultimate authority" with respect to the conduct in question, which requires at least the "power to review... and overturn a decision that fails to accord with state policy": *Patrick v. Budget*.[28] The availability of judicial review processes of the regular courts may in some cases by sufficient for this purpose if those processes permit a review of the fairness of procedures and also of the consistency of the decision with state policy on the merits.[29]

A similar principle has been found to apply under U.S. law to governmental lobbying efforts by private interest groups in a doctrine known as "Noerr-Pennington," named after two United States Supreme Court cases. That Court held that the *Sherman Act* does not prevent persons from associating together in an attempt to persuade the legislature or the executive to take particular action with respect to a law that would produce a restraint or a monopoly: *Eastern R.R. Presidents Conference v. Noerr Motor Freight*,

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[23] 317 U.S. 341 (1943).

[24] 95 S.Ct. 2004 (1975).

[25] 471 U.S. 48 (1985).

[26] 445 U.S. 97 (1980).

[27] 97 S.Ct. 2691 at 2698 (1977).

[28] 108 S.Ct. 1658 (1988).

[29] See for example, *Bolt v. Halifax Hospital Medical Center* (11th Cir., 1988).

Inc..[30] That case involved an action by truck operators and their trade association for damages against a group of railroads arising from a publicity and letter-writing campaign for a change in the laws relating to the long-distance freight business. Where the injury was only incidental to a genuine attempt to influence government action it was found not be actionable. The protection also extends to efforts to influence administrative action in an anti-competitive fashion: *United Mine Workers v. Pennington*.[31]

On the other hand, the U.S. Supreme Court has also held that successful concerted efforts by manufacturers of steel electrical conduit to prevent plastic conduit from being accepted in the fire prevention industry's electrical code was not insulated from the antitrust laws by *Noerr-Pennington* even though legislatures routinely adopt the code. The detail of the conduct was considered and found to be more of a manipulative commercial nature with a political impact, than political activity with a commercial impact: *Allied Tube & Conduit v. Indian Head, Inc.*.[32]

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[30] 365 U.S. 127 (1961).

[31] 381 U.S. 657 (1965).

[32] 108 S.Ct. 1931 (1988).

Chapter 21

REGULATORY INTERVENTIONS BY THE BUREAU OF COMPETITION POLICY

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1.0 INTRODUCTION

As a general proposition, competition is relied upon in the Canadian mixed-enterprise system to control business conduct that may give rise to adverse economic performance. In this regard, the primary objective of the *Competition Act* is to maintain and encourage competition in order to promote efficiency and adaptability of the Canadian economy. However, in certain situations direct regulation of economic activity may be necessary so as to foster other objectives, which at times may be contrary to those pursued by competition policy. In such situations it is important to be fully aware of the implications for competition and the associated costs of economic regulation.

Under provisions of the *Competition Act*, the Director of Investigation and Research is authorized to make representations and call for evidence on competition related issues being examined by federal and provincial regulatory boards and tribunals. By assuming the role of an intervenor to protect the public interest in competition, the Director provides expert advice to regulatory authorities in order that their policy deliberations leave as much scope as is possible for market forces to play their traditional role.[1]

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[*]. The opinions expressed are those of the author and do not reflect the position of the Bureau of Competition Policy, Consumer and Corporate Affairs Canada. I am indebted to June Romain for typing this paper.

This paper first briefly reviews the origins and evolution of the provisions of the *Competition Act* which permit the Director to make representations to regulatory bodies and tribunals. Second, it presents an overview of the nature and type of these representations by the Director and the outcome of the regulatory deliberations during the period 1976-1986.

2.0 BACKGROUND AND LEGISLATIVE AMENDMENTS

Under section 125 of the *Competition Act*,[2] the Director may on his own initiative and shall, on the direction of the Minister, make representations and call for evidence before regulatory boards and tribunals in respect of competition. Under section 126 of the *Act*, the Director may upon consent or invititation make similar representations before provincial regulatory boards and tribunals. See Figure 1.

The role of the Director as an intervenor in regulatory proceedings can be traced to the *Interim Report on Competition Policy* published by the Economic Council of Canada in July, 1969.[3] Subsequent legislative proposals which would permit the Director to make representations in these proceedings were put forward, the first being incorporated in Bill C-256 introduced in Parliament in June, 1971. However, it was not until 1976 that a specific provision (section 27.1) came into effect as part of the Stage I amendments to the *Combines Investigation Act*.[4] As explained below, this provision was further amended with the passage of the *Competition Act* in 1986.

Several reasons may be advanced justifying the Director's role in regulatory proceedings most important of which is to protect the public interest in competition. Competition remains the most effective and least costly method of promoting efficient allocation of scarce resources, eliminating or reducing economic distortions, limiting market power and ensuring low prices and fostering technological change and innovation. However, it may be noted that initiatives toward deregulation in the United States, particularly in the transportation and communications sectors likely influenced and accelerated Canadian policy as well. The communications sector was specifically mentioned by the Economic Council of Canada as one where its growth may be constrained by the regulatory environment.[5]

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[1] Annual Report, Director of Investigation and Research, *Combines Investigation Act*, March 31, 1978, p. 24.

[2] R.S.C., 1985, c. C-34 (the section numbers are those in effect since December 12, 1988).

[3] Economic Council of Canada, *Interim Report on Competition Policy* (Ottawa: Queen's Printer, 1969).

[4] See Bureau of Competition Policy, *Background Papers: Stage I Competition Policy* (Ottawa: Department of Consumer and Corporate Affairs).

There are several reasons for the 1986 amendments and additions to the provision dealing with representations to federal regulatory boards. First, there was need to clarify the intent and purpose of the provision concerning representations, as arguments arose in submissions that "maintenance" of competition should be interpreted as preserving the status quo so as to prevent the Director from making representations to change existing uncompetitive situations. This was not the original intent of this section and was construed as being unacceptable from the standpoint of dynamic change. Further, the objective of encouraging competition is expressly stated and added to the Purpose clause of the *Competition Act* (S.1.1).

Second, there was need to change the scope of representations to federal boards. Representations were to be permitted only to federal boards that carry on activities that relate directly or indirectly to production, supply, acquisition or distribution of a product. In addition, representations to federal "*ad hoc* commissions" of inquiry were also excluded as these are arranged for the purpose of expressing independent opinions and providing independent recommendations.

Third, the need to permit the Director to appear before provincial boards became increasingly apparent, consequently section 126 was added. Section 126 is similar to the provision pertaining to representations to federal boards, except that the Director can only make representations at the request or with the consent of the respective provincial board. See Figure 1.

3.0 THE NATURE AND TYPE OF ISSUES ADDRESSED BY THE DIRECTOR

During the period 1976-1986, a total of 118 representations were made to various regulatory agencies, tribunals and commissions by the Director. Table 1 presents summary information on these representations classified by sector and by principal issue such as license and access applications; modification of existing or proposed regulations; and rate/tariff applications.[6] It will be noted that the majority of the representations were in the transportation (45) and communications sectors (42). The remaining sectors such as finance, agriculture, resources and services combined account for 31 or approximately 26% of the total number of representations.

The general thrust of the Director's submissions have been to promote competition by seeking to reduce regulatory barriers to entry and rate controls, particularly in the transportation and communications sectors. The submissions across different sectors have also addressed a wide range of competition related issues such as cross-subsidization, costs, mergers and supply quotas.

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[5] Economic Council of Canada, *op. cit.*, p. 160.

[6] The detailed list of interventions underlying Table 1 is provided in Table 3.

The extent to which the Director's submissions have contributed to fostering a more competitive environment is difficult to guage. It is not possible to attribute a greater impact of the Director vis-a-vis other intervenors or the influence of exogenous factors such as events in the United States in regulatory decision making. However, it is still of some interest to examine whether the outcomes of regulatory proceedings were favourable, partially favourable or unfavourable in respect to the objectives of competition policy. Table 2 classifies the 118 representations according to these three categories.

In arriving at these various results, it should be remembered that the decision in each representation is given equal weight. In terms of percentage, excluding the representations withdrawn during the proceedings, the decisions in fifty-nine percent were favourable, the decisions in seventeen percent were partially favourable, and twenty-three percent of the decisions were unfavourable. On a sectoral basis, the results in the transportation sector have tended to be better than the results in the communications, and other sectors.

In a recent article, Schultz has indicated that in sectors other than transportation or communications or where some limited form of competition exists or is emerging, there has been some reticence by the Director to intervene in proceedings relating to heavily regulated industries where established policies may be antithetical to competition.[7]

There are several reasons for this reticence. First the approach of the Director has been deliberately selective and timed to correspond when the representations are likely to have the greatest impact. For instance, up until 1981 making representations in the air subsector of transportation would have been futile as the Canadian Transport Commission was not receptive to the notion of introducing competition among the airlines until deregulation was instituted in the United States[8] and significant number of Canadian passengers travelled across Canada via U.S. points. Similarly, representations in the financial sector were concentrated and timed when regulatory reform was being introduced into that sector. Second, competitive concens must be relevant to the board and be one of the factors that is under consideration. Third, given limited resources the representations had to be necessarily selective. As a result, representations in areas where decisions were likely to be unfavourable - for example, submissions in heavily regulated areas and representations opposing mergers under the previous ineffective provisions of the *Combines Investigation Act* were given a lower priority in the selection process.

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[7] N.J. Schultz, "Commentary: Competition Advocacy in the Deregulation Era," *Canadian Competition Policy Record*, Vol. 10, No. 3, September 1989, pp. 42-43.

[8] See Tae Oum, W.T. Stanbury and M.W. Tretheway, "Airline Deregulation in Canada and Its Economic Effects," *Transportation Journal* (forthcoming).

Notwithstanding these considerations Schultz recognizes the overall success of the Director's regulatory interventions and argues for increased emphasis to this function of the Bureau of Competition Policy.

Table 1

FORMAL INTERVENTIONS AND OTHER REPRESENTATIONS BY ISSUE AND SECTOR, 1976-1986

	Transport	Communication	International	Resource	Agriculture	Finance	Service*	Issue Other**	Total
Rate/Tar. App.		12		1					13
Licence & Access App.	21	14				1			36
Merger/Agreement	5	3							8
Supply Management					5				5
Dumping/Imports			4	1					5
Tariff Protection			2						2
Fee/Price Setting						2	2		4
Space Apportionment				1					1
Regulation	12	2		1		3	1	2	21
Policy 5	3	1			3		1	13	
General	2	8							10
TOTAL	45	42	7	4	5	9	3	3	118

The issue has been obtained after examining the formal interventions and other representations published in the above source.

* These representations were to Professional Societies

** These three representations were on the Patent Act/Pharmaceutical Industry; Copyright Act; and, Economic Union and Development Prospects for Canada.

Source: *Annual Reports* of Director of Investigation and Research, 1976-1986.

Table 2

DECISIONS OF THE REGULATORY AGENCIES OBTAINED FROM THE DIRECTOR'S ANNUAL REPORTS AND OTHER PUBLISHED SOURCES, 1976-1986

Sector		Favourable	Partially Favourable	Unfavourable	Withdrawn
Transport	45	29	6	7	3
Communications	42	21	8	10	3
Other	31	16	5	9	1
TOTAL	118	66	19	26	7

Table 3

LIST OF REGULATORY INTERVENTIONS BY YEAR AND SECTOR

1976-1977

- Transportation

1. Canadian Transport Commission, transfer of a commercial licence from White River Air Services Ltd. to Sports Air Ltd.

- Communications

2. Telesat Canada, Proposed Agreement with Trans-Canada Telephone System.
3. Bell Canada Rate Application, April 1977.

- Finance

4. Ontario Securities Commission, hearings on fixed commission rates at the Toronto Stock Exchange.

1977-1978

- Transportation

5. Air Canada proposed acquisition of Nordair Ltd.

- Communications

6. Bell Rate Application, 1978.
7. CNCP Telecommunications application for Access to Bell Canada System for Telecommunication Traffic.
8. Challenge Communications Ltd. vs. Bell Canada, concerning application for tariff review.
9. Colins Inc. vs. Bell Canada, concerning application for supply selector level numbers.

- Services

10. The Professional Organizations Committee of Ontario, concerning statutes dealing with professional organizations.

1978-1979

- Communications

11. Maritime Telegraph and Telephone Company Limited Application for Tariff Approval of a Voice Page.
12. New Brunswick Telephone Company, Limited Application for Network Extension Telephone Service.

1979-1980

- Communications

13. Bell Canada and British Columbia Telephone Company
    Applications for Approval of Increases in Rates for Services Provided by the Members of the Trans-Canada Telephone System (TCTS).
14. Bell Canada, Connection of Customer Provided Terminal Devices.
15. British Columbia Telephone Company Proposed Acquisition of GTE Automatic Electric (Canada) Limited and Microtel Pacific Research Limited.
16. Garden of the Gulf Motel Application for Connection of COAM PABX to Island Telephone Company Limited System.

1980-1981

- Transportation

17. Domestic Advance Booking Charters - Comments on domestic charter regulations.

- Communications

18. Bell Canada, General Rate Increase, 1981.
19. Bell Canada, General Increase in Rates, 1980: Northern Telecom Price Comparisons Test.

- International

20. Tariff Board Reference 159 - Modification of the Value for Duty Provisions of the Customs Act.
21. Tariff Board 158 - General Preferential Tariff Extensions and Reductions.

- Agriculture

22. National Farm Products Marketing Council, consideration of a proposal to establish a Potato Marketing Agency for Eastern Canada.

Table 3 - continued

1981-1982

- Transportation

23. Canadian Transport Commission - Shipping Conference Exemption Act.
24. Standing Committee on Transportation - Domestic Air Carrier Policy.
25. Domestic Air Carrier Policy, 1981.
26. Draft General Rules of the Canadian Transport Commission - Comments.

- Communications

27. Pay Television - Application for licences.
28. CRTC Telecom Cost Inquiry - Phase III - Costing of Existing Services.
29. Ontario Telephone Service Commission concerning terminal attachment in Ontario.
30. Régie des services publics du Québec concerning terminal attachment in Québec.
31. Alberta Government Telephones - Terminal Attachment.
32. Newfoundland Government Telephone Company Limited - Mobile Radio and Paging Services, pertaining to cross-subsidization from a tariff.
33. DOC/Microwave Licensing.

- International

34. Tariff Board Reference 157 - Tariff Items Covering Goods Made/Not Made in Canada, Phase I.
35. House of Commons Sub-Committee on Import Policy.

- Finance

36. Ontario Securities Commission Hearings on Competitive Rates.

1982-1983

- Transportation

37. Legan Bus Lines, Edmonton - Application for a bus licence.
38. CTC Public Hearing into "Deep Discount" Domestic Air Fare Rules.

- Communications

39. Radio Common Carrier Interconnection with Federally Regulated Telephone Companies.
40. Bell Canada Corporate Reorganization.
41. New Brunswick Telephone Company Limited Application for an Interpretation of Certain Provisions of its General Tariff.
42. Alberta Government Telephones - Selector Level Access Rates.
43. Role of Telesat Review.

- Agriculture

44. Fact Finding Inquiry into Egg Production Costs.
45. Régie des marchés agricoles du Québec - Controls on the Wholesale and Retail Prices of Milk.
46. Régie des marchés agricoles du Québec - Submission on the establishment of a marketing board for maple syrup.

1983-1984

- Transportation

47. Federal Express - Application to Amend its Commercial Air Services Licence.
48. Air Ontario Ltd. - Application for Scheduled Passenger Service, Sudbury and North Bay, Ontario.
49. Air Ontario Ltd. - Application for Scheduled Passenger Service, Hartford, Connecticut.
50. Voyageur Airways - Application for Scheduled Passenger service between Toronto Island Airport and Windsor, Ontario.
51. Kelowana Flightcraft Air Charter Limited - Application for Scheduled Passenger Service.
52. Review of proposed Canadian National Acquisition of an Interest in Cast Container Group.
53. Review of Canadian National's payments of Rebates to the Cast Container Group.
54. Canada Southern Railway acquisition by CN Railway and CP Railway.
55. Regulations affecting Freight Interswitching between Canadian Railways.
56. CTC Review of the Economic Regulation of Commercial Air Services Using Rotary Wing Aircraft.
57. Alberta - Review of Intercity Bus and Trucking Regulation.
58. Domestic Air Fare Policy Review.
59. Manitoba Review of Motor Carrier Regulations.

- Communications

60. Pay Television policy review.
61. Telesat Canada - Final Rates for 14/12 GHz Service: Resale and Sharing.
62. Enhanced services application by Bell Canada.
63. Services Using Vertical Blanking Interval or Subsidiary Communication Multiplex Operation.
64. Tiering of Cable Service and Universal pay Television.
65. Alberta Government Telephones - 1983 Rate Application.
66. Interconnection in the Telecommunications Industry in New Brunswick.
67. Attachment of Customer-owned Terminal Equipment to the Public Switched Network in Nova Scotia.

Table 3 - continued

- Resources

68. National Energy Board Hearings on Heavy Fuel Oil imports and exports.
69. Ontario Energy Board Hearings Concerning Ontario Industries Using Natural Gas as a Feedstock.

- Agriculture

70. Establishment of a National Agency for Broiler Type Chicken Hatching Eggs.

- Finance

71. Ontario Securities Commission - Review of the Role of Financial Institutions in the Brokerage Industry.

- Services

72. Professional Engineers Act and Architects Act, Province of Ontario - On setting of schedules of suggested fees.

1984-1985

- Transportation

73. Austin Airways Intervention - Application for a licence.
74. Pacific Western Airlines - Application to Consolidate Licences.
75. Kelowna Flightcraft - Application to Amend its Commercial Air Services Licence.
76. Nordair - Application to serve Sudbury, Timmins and North Bay, Ontario.
77. Voyageur Airways Ltd. - Application to Consolidate Licences.
78. Eastern Provincial Airways - Application to Consolidate Licences.
79. Quebec Aviation Ltd. - Application to Consolidate Licences.
80. Staggers Rail Act of 1980-Implications.
81. R. McCargar Trucking Ltd. - Operating Authority Application before the Manitoba Motor Transport Board.
82. Kleysen Transport - Application for a trucking licence before the MMTB.
83. V.O.T. Transport Ltd - Application for a trucking licence before the Ontario Motor Transport Board.
84. Hillside Auto Carrier Limited - Application for a trucking licence before the New Brunswick Motor Carrier Board.
85. Multimodal Integration - Comments on CTC review.
86. Regional Taxicab Licensing - Lower Mainland of British Columbia.

- Communications

87. Restructuring of Pay Television Industry.
88. Interexchange Competition and Related Issues.
89. British Columbia Telephone Company 1984 CRTC Construction Program Review.
90. Cable Television Rate Indexing.
91. Structural Separation of Multiline and Data Terminal Equipment.

- International

92. Anti-dumping Tribunal - Refined Sugar dumped into Canada.
93. Foot-wear Inquiry Intervention - The Canadian Import Tribunal, the impact of import quotas.

- Resources

94. National Energy Board Hearings - Review of Toll Design and Methodology of Trans Canada Pipelines Limited.

- Finance

95. Financial Markets: Ontario Security Policy Review.
96. Regulation of Financial Markets.

- Other

97. Section 41(4) of the Patent Act and the Government Policy in the Pharmaceutical industry.
98. Royal Commission on the Economic Union and Development Prospects for Canada (MacDonald Commission).

1985-1986

- Transportation

99. Nordair Inc. - Application to Consolidate Licences.
100. Soundair Corporation (Commuter Express), Mississauga - Request to Operate Toronto to Cleveland.
101. Air Atlantic Ltd. - Application to Operate a Commercial Air Service.
102. Wardair Canada Inc. - Application to Operate Scheduled Commercial Air Service.
103. Roadway Express Ltd. - Intervention before the Ontario Highway Transport Board on transfer of trucking licences.
104. Prairie Provinces Joint Hearing - Trucking - On development of common list of commodities.
105. Proposed Regionalization of General Freight Carriers licence - Manitoba.
106. Freedom to Move - House of Commons Standing Committee on Transport, comments on regulatory reform paper.
107. Airport Management Task Force, review of airport management policy.

Table 3 - continued

- Communications

108. Telesat Canada / Telecom Canada Connecting Agreement.
109. British Columbia Telephone Company - Purchasing Policy.
110. Resale of Primary Exchange Service.

- International

111. Canadian Import Tribunal - Surgical Tapes dumped into Canada.

- Resources

112. National Energy Board - Review of the Tariffs of Interprovincial Pipe Line Limited relating to the apportionment of space among shippers on its pipeline system.

- Finance

113. Parliamentary Committee Hearing Concerning the Regulation of Canadian Financial Institutions.
114. Regulation of Financial Markets.
115. Corporate Defensive Tactics - Comments on OSC policy.
116. Senate - Financial Markets - Comments on green paper on financial deregulation.

- Services

117. Office des professions du Québec renewal of tariff of fees.

- Other

118. Revisions to Canadian Copyright Law.

Note: The number of formal representations and other representations listed in each year may marginally differ form those reported in the *Annual Reports, Director of Investigation and Research, Combines Investigation Act*, because of differences in classification and reporting systems used by the author.

Figure 1

STATUTORY PROVISIONS RE REGULATORY INTERVENTIONS

1. *Combines Investigation Act*: January 1, 1976 to June 18, 1986

27.1 (1) The Director, at the request of any federal board, commission or other tribunal or upon his own initiative, may, and upon direction from the Minister shall, make representations to and call evidence before any such board, commission or other tribunal in respect of the maintenance of competition, whenever such representations or evidence are or is relevant to a matter before the board, commission or other tribunal, and to the factors that the board, commission or other tribunal is entitled to take into consideration in determining such matter.

(2) For the purposes of this section, "federal board, commission or other tribunal" means any board, commission, tribunal or person who is expressly charged by or pursuant to an enactment of Parliament with the responsibility of making decisions or recommendations related directly or indirectly to the production, supply, acquisition or distribution of a product and includes an *ad hoc* commission of inquiry charged with any such responsibility but does not include a court. 1974-75-76, c. 76, s. 9.

2. *Competition Act*: June 19, 1986 -

125 (1) The Director, at the request of any federal board, commission or other tribunal or on his own initiative, may, and on direction from the Minister shall, make representations to and call evidence before the board, commission or other tribunal in respect of competition, whenever such representations are, or evidence is, relevant to a matter before the board, commission or other tribunal, and to the factors that the board, commission or other tribunal is entitled to take into consideration in determining the matter.

(2) For the purposes of this section, "federal board, commission or other tribunal" means any board, commission, tribunal or person that carries on regulatory activities and is expressly charged by or pursuant to an enactment of Parliament with the responsibility of making decisions or recommendations related directly or indirectly to the production, supply, acquisition or distribution of a product. 1986, c. 26, s. 47.

126 (1) The Director, at the request of any provincial board, commission or other tribunal, or on his own initiative with the consent of the board, commission or other tribunal, may make representations to and call evidence before the board, commission or other tribunal in respect of competition, whenever such representations are, or evidence is, relevant to a matter before the board, commission or other tribunal, and to the factors that the board, commission or other tribunal is entitled to take into consideration in determining the matter.

(2) For the purposes of this section, "provincial board, commission or other tribunal" means any board, commission, tribunal or person that carries on regulatory activities and is expressly charged by or pursuant to an enactment of the legislature of a province with the responsibility of making decisions or recommendations related directly or indirectly to the production, supply, acquisition or distribution of a product. 1986, c. 26, s. 47.

Chapter 22

INTELLECTUAL PROPERTY RIGHTS: ANTICOMPETITIVE ABUSES AND COMPETITION POLICY ANTIDOTES

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1.0 INTRODUCTION

The tension between the protection of intellectual property rights and the promotion of competition has long been an issue for both economists and the legal profession. The tension exists because such rights can concurrently generate social benefits in the form of intellectual creation, and social costs associated with market power. As a result, there exists an uneasy relationship between competition policy and intellectual property rights.

From a social welfare perspective, the primary rationale for granting such rights is to provide a pecuniary incentive for intellectual creativity.[1] New technological and commercial knowledge has certain attributes of a public good. That is, once created such knowledge is generally freely appropriable by others, and this "free-rider" problem limits the incentive to create new knowledge. By conferring rights that restrict the wider (unauthorized) use of new knowledge, intellectual property laws are supposed to create the incentive for firms to engage in creative activities and to undertake the risks and expenditures associated with innovation (Levin, 1986). A second potential social benefit of the intellectual property right system is disclosure. This is particularly relevant to patents where the grant of the right requires disclosure of the creation. This "exchange-for-secrets" rationale presumes that disclosure will facilitate further creativity.

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[*] The excellent research assistance of Ms. Sandra McMillan is gratefully acknowledged.

[1] There are other perspectives such as natural law which would view the creator as having a natural property right to his or her creations.

There is a risk when granting limited legal monopolies that inefficiencies and inequities associated with the exercise of market power will outweigh the social benefits derived from the creation, early introduction, and wider dissemination of new knowledge. Intellectual property laws create an incentive for firms to seek the entrepreneurial, albeit monopoly, rents associated with Schumpeterian competition. However, they also create an incentive and a vehicle for the firm to extend their market power in time, across markets and across products.

The purpose of this paper is to consider the legislative safeguards against potential abuses of intellectual property protection and whether there is an argument for strengthening present safeguards. In carrying out this task, the four major pieces of Canadian legislation in the intellectual property area (the *Patent Act*, the *Trade Marks Act*, the *Copyright Act*, and the *Industrial Design Act*) are briefly reviewed. This is followed by a discussion of the potential abuses associated with these various forms of intellectual property protection, the antitrust experience in other jurisdictions and the remedies available under the relevant Canadian legislation.

2.0 INTELLECTUAL PROPERTY RIGHTS LEGISLATION

In this section, the main features of the major pieces of intellectual property rights legislation in Canada are summarized.

2.1 Patent Act

Certain features of the *Patent Act* limit the life and scope of any market power derived from this intellectual property right. With the coming into effect in October 1989 of the revisions to the *Act*, the grant has been extended from 17 to 20 years.[2] Also, Canada has imposed maintenance fees to encourage the removal of inactive patents from the Patent Office files.

The scope of the patent property right is also constrained by what is deemed to be patentable. Generally, a patentable invention includes any new and useful process, machine, method of manufacture or composition of matter, or any new and useful improvement thereof. Normally, patents are not granted to obvious improvements of known devices or processes, scientific theorems or principles, recipes, designs, or computer programs.

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[2] Bill C-22, which amended the *Patent Act*, received Royal Assent on November 19, 1987 and came fully into effect in October 1989.

In addition to constraining the life and the scope of the patent right, the *Act* further restricts the way in which the right can be worked. Under Canadian law, if it is determined that the patent has been abused, there are several remedies including compulsory licensing and revocation of the patent. Under S.65 of the *Patent Act*, the following can constitute abuse:

- the patent invention is capable of being worked in Canada but is not being worked on a commercial scale;
- the working of the invention in Canada is prevented or hindered by importation of the patented article by the patentee or by others against whom the patentee has not taken action for infringement;
- demand for the patented article in Canada is not being met to an adequate extent on reasonable terms;
- the patentee's refusal to license the patent, or the conditions attached to a license prejudice the trade or industry of Canada or the trade of any person or class of persons trading in Canada, or the establishment of any new trade or industry; and
- the utilization of a patent prejudices in Canada the manufacture, use or sale of unpatented materials used as inputs.

The Canadian *Patent Act* contains provisions to curb perceived abuses which go well beyond competition issues. For example, the *Act* clearly encourages the working of the patent in Canada, and discourages both "over-exploitation" of the patent grant and prejudicial effects on trade and industry in Canada.

Before leaving this general description of the Canadian patent system, two further points should be made. First, the overwhelming majority of Canadian patents are granted to non-Canadians. Historically about 95% of Canadian patents are held by non-Canadians, mostly United States residents. Second, patents are of much greater importance to some industries than others. Scherer found, for the United States, a very high proportion of patents attributable to the electrical and general chemicals industries. He attributed this,

> ...mainly to the vigorous scientific climate of those fields, which has assured a continuous supply of new technical possibilities exploitable to satisfy existing or latent demands. In effect, science and technology exert a push on inventive output in these fields (Scherer, 1984, p. 179).

In Canada, product patents are highly concentrated in three sectors, electrical products, machinery and chemical products, which together accounted for well over half of all product patents registered in 1984/85 (see Table 1).

Moreover, there is significant inter-industry variation in the importance of patents to the development of products. Based upon a random sample of

100 firms in 12 industries in the United States, Edwin Mansfield (1986) found that patent protection was essential for the development or introduction of 30 percent or more of the inventions in only two: pharmaceuticals and chemicals. His results are summarized in Table 2.

2.2 Copyright Act

Copyright originally meant the right to copy printed material. Over the years copyright protection has evolved with changes in communication and reproduction technology. Today, such protection is afforded original literary, musical, artistic and dramatic works and covers books, films, choreographs, records, audio and video tapes, songs, sculptures, lectures, paintings, photos, and more recently, computer programs.

In Canada, the term of copyright protection is the lifetime of the creator and 50 years thereafter. The *Act* also provides remedies in the event that material protected by copyright is withheld from the market. For example, if after the death of the author the owner of the copyright refuses to allow exposure of a work which has been published or performed in public, the Governor in Council (Cabinet) can impose compulsory licensing. In the case of books, compulsory licensing is possible during the lifetime of the author if the copyright owner fails to print the book in Canada or fails to print enough copies to satisfy the reasonable demands of the Canadian market for the book.

2.3 Trade Marks Act

A trademark is a word, symbol or picture, or a combination of these, which is used to distinguish the goods or services of one person or enterprise from those of another. The *Trade Marks Act*[3] is less restrictive than the *Patent Act*. In effect a person or organization is entitled to the granting of a mark as long as the mark is not held nor can be confused with a mark held by someone else. The life of a trademark is indefinite as rights to the mark are granted for an initial 15 years and are renewable every 15 years thereafter.

A mark can be expunged if it is not in use in Canada and if there are no special circumstances that excuse the non-use. Otherwise, there are no abuse provisions in the *Act*.

2.4 Industrial Design Act

Industrial design deals with the physical appearance of articles of manufacture and includes shapes, features or ornamentation which are intended to have an aesthetic effect. Industrial design does not apply to functional or useful features.

The term of an industrial design is five years, and it may be renewed at or before expiration for a further period of five years. The total life of the design right cannot exceed 10 years. There are no abuse provisions in the *Industrial Design Act*.

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[3] R.S.C. 170, c. T-10. With the Revised Statutes of Canada 1985, it became the *Trade-marks Act*, R.S.C. 1985, c. T-13 effective December 12, 1988.

Each of these intellectual property rights confers exclusive privileges for a fixed period of time. Several contain explicit abuse provisions. The following discussion addresses these abuses and potential antidotes in greater detail.

3.0 ABUSES OF INTELLECTUAL PROPERTY RIGHTS

The awarding of patent, copyright and industrial design grants involves society in a trade-off between allocative and dynamic efficiency. The market power flowing from the right conflicts with the achievement of allocative efficiency. This social cost is incurred in the interests of dynamic efficiency which includes the introduction of new products, processes, creative works and industrial designs. It is in society's interest to minimize the allocative inefficiencies and maximize the dynamic efficiencies.[4]

Allocative inefficiency can be minimized by limiting the exercise of market power within the immediate market affected by the property right and by insuring that it is not extended beyond that market. On the other hand, to fully reap the benefits of potential dynamic efficiencies, society must insure that the intellectual property is fully disclosed and worked. Obviously, if the intellectual property right is used to suppress knowledge or stifle technological development this will tilt the balance against a net benefit to society.

Trademark grants are not based on a dynamic efficiency rationale. Historically, trademark was used to inform the consumer of a product's origin. The trademark protected the customer from counterfeit goods and protected the seller from the unfair competition of counterfeiters. Insofar as knowledge of origin also provides information about product characteristics, particularly quality, the trademark reduces buyers' transaction costs. This is welfare enhancing. Caves and Murphy (1976, pp. 584-585) argue that origin and quality are related because by "offering the seller's good name as hostage, the trademark provides the buyers with cheap information and assurance about product quality." Be that as it may, some would argue that trademark licensing has weakened the connection between origin and product characteristics and thereby reduced benefits of the grant to consumers. The social cost is once again allocative efficiency in that trademarks can enhance the degree of product differentiation which can exacerbate barriers to market entry.

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[4] Dynamic efficiency requires that current resources be allocated to R&D up to the point that the marginal costs of invention and innovation be just equal to their marginal benefits (properly discounted for time and risk). Obviously the most rapid technological change is not necessarily the most dynamically efficient (e.g., the cost of accelerating technological change may not be matched by the benefits of early introduction). See Scherer (1984, pp. 67-82).

A review of Canadian jurisprudence bearing on intellectual property rights suggests that there are three broad, and not completely mutually exclusive, categories of perceived abuses. The first involves the impact of the exercise of the right on economic activity in Canada. The second concerns the degree to which the right holder can exploit the exclusive privilege. The third deals with the extension of the right in time and across markets.

4.0 INTELLECTUAL PROPERTY RIGHTS AND ECONOMIC ACTIVITY: POTENTIAL ABUSES AND ANTIDOTES

There are concerns, which really do not qualify as narrowly-defined competition policy issues, that the exercise of intellectual property rights can impede economic development and curb economic activity. For example, if the dissemination and application of, say, a process innovation is suppressed through the exercise of the right this can retard the industry in question, and both upstream and downstream industries. Pushed further, this can have deleterious effects on employment, international trade, and technological development.

These concerns are addressed in Canadian intellectual property rights laws. The *Patent Act* provides for a weakening (compulsory licensing) or revocation of the patent right when abuse has been determined. The abuse provisions of the *Act* proscribe behaviour which curbs economic activity in Canada, whether in the working of the patent itself, development of the relevant industry, or development of upstream and downstream industries. Food and drugs are singled out for special treatment, assumedly because they qualify as "necessities." The *Copyright Act* has provisions for compulsory licensing if a copyrighted book is not printed in Canada.

From a consumer perspective, the working of the right in Canada is not necessarily essential for welfare maximization. Certainly the right should not be used to deny the product or service to Canadians, but the "made-in-Canada" condition does not offer obvious welfare gains. For example, in some instances a requirement that the right be worked in Canada could result in the establishment of inefficiently small suppliers. The result would be higher costs and ultimately higher prices than if the product were imported. In any case, the *Patent Act* does allow that the patent must be "capable of being worked in Canada" before an abuse for non-working is found. Assumedly this allows a scale economy defence for failing to work the patent on a commercial scale.

In sum, intellectual property rights legislation appears to have adequate safeguards against the overt suppression of protected knowledge and the imposition of overly restrictive conditions on the use of such knowledge which would "prejudice the trade or industry of Canada." It should also be kept in mind that there is room for private enforcement. Idle patents, copyrights, trademarks and industrial designs can be challenged by private parties seeking use of these properties.

5.0 EXPLOITATION OF THE RIGHT: POTENTIAL ABUSES AND ANTIDOTES

The second broad category of abuse involves the question of whether "within his own domain the patentee is czar?" The granting of the right gives the grantee exclusive rights within an explicit, limited domain. Can the grantee extract all monopoly rents within that domain? In other situations where society bestows exclusive rights to supply, such as regulated "natural" monopolies, the beneficiary's market conduct is controlled to avoid the abuse of market power. At a minimum, the regulated monopolist's profits are restrained, and commonly it is forced by regulation to implement policies with broadly distributed social benefits. In a similar vein, "abuse" of an intellectual property right might include "overly rapacious" exploitation of market power derived from the right.

Canadian law deals directly with the "over exploitation" of intellectual property rights. The reference in the *Patent Act* to a failure to meet Canadian demand for a patented product on "reasonable" terms suggests that setting too high a price could run afoul of the law. Similarly, the reference in the *Copyright Act* of a failure to meet the reasonable demands of the Canadian market for books suggests that "shorting the market" could lead to compulsory licensing of copyright protected material.

5.1 Price Discrimination

Under certain conditions, extraction of all monopoly rents attributable to the property right entails price discrimination. Generally, successful price discrimination requires that the seller possess market power, that markets with differing price elasticities can be identified, and that arbitrage between high and low priced markets can be curbed. The intellectual property right can confer market power and can be used to control arbitrage.

Industrial economists have long had a fairly benign view of price discrimination, based largely on the premise that in aggregate it leads to increased output and therefore, increased social welfare. In the domestic context, discrimination results in a transfer of welfare from domestic consumers to domestic suppliers, and, as long as it does not injure competition, is legal (see Director of Investigation and Research, 1990). Price discrimination does have unbalanced effects on different groups. For example, when a single price monopolist switches to perfect price discrimination, consumers who were served under the single price regime will experience a loss in consumer surplus. Those who are served only under the price discrimination regime will experience an increase in welfare as will the discriminator. This redistribution may raise equity issues, but total (producer and consumer) domestic welfare is increased. However, the welfare implications are quite different when markets are segmented on the basis of national boundaries and Canada is identified as a higher-priced market.

At issue here is the use of intellectual property rights to reinforce a multinational enterprise's price discrimination strategy. The concern is that Canadian consumers' welfare will be reduced when a multinational enterprise price discriminates against the Canadian market (i.e., charges a higher,non-cost justified price in Canada than elsewhere) and uses Canadian intellectual property rights to curb the imports of the product from lower priced markets. This has long been understood as a potential problem in Canada especially when recognizing that most Canadian patents are held by non-Canadians (i.e., if Canada is the high-priced market, not only is wealth transferred from consumers to producers, it is captured by non-Canadian patent holders).

Intellectual property rights can be integral to an international price discrimination strategy because they provide a legal means to hinder leakages between markets. Most countries provide domestic rights holders with protection from the importation of counterfeit goods, or goods which reflect or incorporate the unauthorized use of the intellectual property in the belief that such protection is justified.[5] In many jurisdictions the domestic customs service provides a policing and enforcement function for the domestic rights holder. However, a price discriminating multinational enterprise might find this protection service an attractive means to stop the importation of goods which originate with a foreign, authorized user of the right. In other words, the price discriminator uses the customs service as an efficient, low cost instrument to stop the inter-market leakages which have come to be called "gray markets" and "parallel trade."

Judging from the current proliferation of litigation, the enforcement of international price discrimination through intellectual property rights is an increasingly contentious issue in the United States.[6] Anecdotal evidence suggests that Canada plays a role in parallel trade both as a source and a destination of gray market goods.

Eschewing the question of whether arbitrage is socially beneficial, our interest is focussed on whether intellectual property rights play an integral part in international price discrimination strategies. At issue is whether the rights holder can impose and enforce territorial restraints on the movement of products which directly or indirectly embody the intellectual property. If the right is exhausted upon first sale, intellectual property legislation cannot be used to curtail international trade in the product. Conversely, territorial divisibility allows the rights holder to stop the importation of products produced by an authorized foreign manufacturer.

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[5] Some observers have argued that the concept of counterfeiting has been applied so broadly that more legitimate forms of product imitation and price arbitrage have been encompassed. See Globerman (1988).

[6] Recent cases have involved cameras, perfumes, shoes, and board games. See note 8 for citations of cases.

5.2 The United States Experience[7]

To date very little jurisprudence has developed in Canada with respect to the use of intellectual property rights to curb gray markets. However, very recently there has been a surge of litigation bearing upon the issue in the United States.

Patents: Under United States jurisprudence, the owner of a product patent has an infringement action against an importer of the product, regardless of the place of first sale, when the relevant licenses restricted the licensee from selling in the United States (see George, 1986). However, the owner of a process patent has no equivalent right against an importer because use or sale of the product does not constitute use or sale of the process used to make it. Therefore, under United States law, importation of an article produced by a patented process without authorization of the patent owner does not constitute patent infringement. The patent owner's only recourse is to bring an administrative action under Section 337 of the U.S. *Tariff Act* alleging that the importation constitutes an unfair practice in import trade. Section 337 requires the patent owner to prove not only that the patent was infringed, but also that the importation of the article is causing or threatening to cause substantial injury to a domestic industry (George, 1986).

Trademarks: The majority of recent cases dealing with constraints on parallel trade have involved trademark law. Section 526 of the U.S. *Tariff Act* prohibits the importation of any merchandise of foreign manufacture if the merchandise bears a trademark owned by a United States citizen, corporation or association, and the trademark is registered by a person domiciled in the United States with the United States Patent and Trademark Office and a copy of the registration certificate has been filed with the United States Customs Service. Goods imported for personal use, and goods imported with the explicit consent of the United States trademark holder are excepted. No exemption is made for foreign goods produced under the authorization of the United States trademark holder or its affiliates.

Section 42 of the Lanham *Trademark Act* of 1946 states that imported merchandise (except for personal use) will not be admitted if it "copies or simulates a United States registered trademark." The *Act* also directs the Secretary of the Treasury to set out regulations whereby United States trademark holders register their marks with the Customs Service in order to assist enforcement. Further, there is no exception made for foreign goods produced under authorization of the United States mark holder or its affiliates.

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[7] This section draws on Plaia and Zalik (1986).

It is through United States Customs Service regulations that the relevant sections of the *Tariff Act* and the Lanham *Trademark Act* are implemented. However, the Customs Service has severely weakened the usefulness of trademarks in restricting parallel trade through these regulations. The Customs Service has permitted the importation of foreign-made articles bearing a trademark owned and recorded by a United States individual or enterprise where:[8]

> 1. both the foreign and the United States trademark or tradename are owned by the same person or business entity;
> 2. the foreign and domestic trademark or trade name owners are parent and subsidiary companies or are other wise subject to common ownership or control (the latter defined as meaning "effective control in policy and operation" but not necessarily greater than 50 percent ownership);
> 3. the articles of foreign manufacture bear a recorded trademark or trade name applied under authorization of the United States owner.

During the early 1980s, when the United States dollar was very strong relative to other currencies and parallel importations to the United States flourished, these custom regulations were repeatedly challenged with mixed results within both the District Courts and the Courts of Appeal.[9]

In one of these cases, *NEC Electronics* v. *Cal Circuit Abco Inc.*, the Customs Service Regulations were upheld and the court spoke directly to the issue of price discrimination.[10] NEC Electronics, a wholly owned subsidiary of a Japanese computer chip manufacturer that had been assigned the manufacturer's United States "NEC" trademark rights, brought suit against a parallel importer of genuine NEC chips. In its decision the court stated,

> If NEC-Japan chooses to sell abroad at lower prices than those it could obtain for the identical product here, that is its business. In doing so, however, it cannot look to United States trademark law to insulate the American market or to vitiate the effects of international trade. This country's trademark law does not offer NEC-Japan a vehicle for establishing a worldwide discriminatory pricing scheme simply through the expedient of setting up an American subsidiary with nominal title to its mark (810 F 2d 1506 (9th Cir, 1987) at p 6).

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[8] 19 CFR Subpart 133.21(c)(1-3).

[9] At the District Court level see: Bell and Howell; *Mamiya Co. v. Masel Supply Co.* 548 F Supp; 1063 (EDNY 1982); 719 F 2d 42 (2d Cir 1983); *Parfums Stern Inc. v. U.S. Customs Service* 575 F Supp 416 (SD Fla 1983); *El Greco Leather Products Co. Inc. v. Shoe World Inc.* 599 F Supp 1380 (EDNY 1984); *Selchon & Righter Co. v. Golden Corp.* 612 F Supp 19 (SD Fla 1985); *Osawa & Company v. B & H Photo* 589 F Supp 1163 (SDNY 1984). At the Appeal Court level compare the decisions in: *Vivitar Corp. v. United States*, 761 F2d 1552 (CA Fed 1985); *Olympus Corp. v. United States*, 792 F2d 315 (CA2 1986) and *Coalition to Preserve the Integrity of American Trademarks v. United States*, 252 US PP DC 342 790 F2d 903 (1986).

[10] 810 F 2d 1506 (9th Cir, 1987).

Ultimately the United States Supreme Court granted *certiorari* in the case of the *Coalition to Preserve the Integrity of American Trademarks* v. *United States* (the so-called COPIAT case) to resolve the conflict among the Courts of Appeals. The United States Supreme Court upheld the Customs Service regulations allowing the importation of United States trademarked merchandise when the domestic and foreign owners of the trademark were either the same entity or were subject to common ownership.[11] However, the Court rejected the regulation allowing importation when the United States trademark holder had merely authorized the foreign manufacturer's use of the mark.

In summary, after considerable legal wrangling, it now appears that a multinational enterprise which holds a trademark in the United States and in another country cannot use the *Tariff Act* to curb parallel imports of the trademarked product. However, if the foreign manufacturer and the United States manufacturer are not under common control, the *Act* can be used to stop imports.

5.3 The Canadian Experience

The potential use of intellectual property rights to strengthen international price discrimination is well recognized in Canada and was directly addressed by the Economic Council in its 1971 report on intellectual property.

> The patent right should be so defined that neither the holder of a Canadian patent nor any licensee thereunder should have the right to prevent the importation into Canada by any person of the patented article, or an article made by the patented process, from other countries where the article or process enjoys patent protection. The main purpose of this recommendation would be to prevent a patentee from using the Canadian patent system as a means of assisting any international price discrimination to Canada's disadvantage – i.e., from charging an unjustifiably higher price in Canada then in other countries where he has patent protection (Economic Council of Canada, 1971, p. 90).

The Council (1971, pp. 125, 153, 205) made similar suggestions with respect to industrial design, trademark, and to a lesser extent, copyright. However, the Council's recommendations have not, for the most part, been acted upon.

Patents: Canadian patent law provides for the right of the patent holder to bar imports from abroad not only when the goods originate from an unrelated party, but also when they have been manufactured and/or first sold by the patentee (or his licensee) who is the assignee or the assignor of the domestic patent, under the protection of a parallel patent. This means importation can be an infringement of a patent even if the product was manufactured outside of Canada under licence from the owner of the corresponding patent in the country of manufacture. This is the case even though the manufacturer or his licensor is a company related to the owner of the Canadian patent as part of an international group of companies or otherwise. As a practical matter, this implies that multinational companies can register patents in Canada and have the Canadian market for the patented product or products produced under a patented process reserved exclusively for their Canadian affiliates. In addition, the Canadian patent right owner can licence that right as it chooses. As terms and conditions of the licence agreement, it can set up a territory, being either part or all of Canada, and grant exclusive licenses to serve each territory.

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[11] *K Mart Corporation* v. *Cartier, Inc. et al.*; *47th Street Photo, Inc.* v. *Coalition to Preserve the Integrity of American Trademarks et al.*; *United States* v. *Coalition to Preserve the Integrity of American Trademarks et al.*, 100 L Ed 2d 313; 108 S Ct 86-495, 86-624, 86-625 (May 1988).

There is some evidence that patents have been used to curtail parallel imports into Canada. Just after World War II the Commissioner, *Combines Investigation Act* (1945), concluded that patents were used to curtail parallel imports of electric lamps, radio tubes and radio sets. Interestingly, the Tariff Board found that Canadian consumers were being exploited by an international patent pool covering radio tubes and sets and had suggested that royalties be reduced.

> As a general proposition, the licence to use certain patented inventions in a given receiving set of Canadian manufacture, should not entitle the holders of such patents to an amount greater than that which is collected in other countries from the use of the said patented inventions in a comparable receiving set. This principle was enunciated in the Board's 1939 Report, and while reductions in the royalty rates were made,.... they are still too high.
>
> [With respect to radio tubes] the Board strongly suggests that the selling margin granted jobbers and dealers should be drastically reduced. The average mark-up on the manufacturers' selling price of 113.11 per centum is ridiculous.... (Commissioner, *Combines Investigation Act*, 1945, p. 24).

More recently, the Director reported the discontinuance of an inquiry involving electrical components wherein it was alleged

> ...that a particular company engaged in the manufacture and distribution of electrical components was charging prices significantly higher than its parent company in the United States. The complaint further alleged that the American parent company had refused to sell at its more favourable prices to Canadian customers and had used patents which it held to restrict competition (Director of Investigation and Research, 1976, p. 27).

This inquiry was subsequently discontinued because it was found that the subject company did not have a monopoly in electrical components and that it had not used patents to enhance prices unreasonably or lessen competition unduly.

Trademarks: Section 52 of the Canadian *Trade Marks Act* allows that when it appears to a court of competent jurisdiction that a registered trademark has been applied to goods imported into Canada and the goods are about to be distributed in a manner contrary to the *Act*, the court can order the interim custody of the goods pending a final determination of the legality of their importation or distribution.

While there is apparently the potential to use trademark protection to curb parallel imports into Canada, there are few documented cases where this strategy was employed. One involves farm machinery. In the late 1960s multinational farm machinery manufacturers sold nearly identical tractors at substantially higher prices in Canada than in Great Britain. The Ontario Federation of Agriculture engaged in parallel importation from Britain and at one point was warned by the solicitor for Ford Motor Company of Canada that it "might be violating the trademarks legislation because of its association with the importation of tractors bearing the trademarks 'Ford' or 'FoMoCo'" (Royal Commission on Farm Machinery, 1969, pp. 89-90). There is no evidence that this threat was acted upon and the Royal Commission investigating the industry found that in fact market separation had been achieved mainly through vertical restraints on distribution.

In its study of intellectual property, the Economic Council (1971) cited the farm machinery case and a potential problem with trademarked pharmaceuticals. However the Council could not determine how widespread the problem might be.

> In the case of other industries, such price differentials may or may not be related to the use of trademarks as a nontariff barrier to trade, but at least in the case of the farm machinery and the drug industries, they appear to have been used to this effect. We are not sure where else they exist but the potential is there and this opportunity should not persist (Economic Council, 1971, p. 202).

Two recent cases raise important issues concerning the ways the *Trade Marks Act* might be used to inhibit international trade in the form of branded goods imported into Canada from the U.S. - goods that are also produced in Canada by the same manufacturer. In *H.J. Heinz Co. of Canada v. Edan Foods Sales Inc.* Cullen J. granted an injunction against Edan preventing it from importing Heinz ketchup made in the U.S. and selling it in Canada.[12] Edan Foods purchased several truckloads of Heinz ketchup at about half the Canadian cost from Heinz (US), which is the parent of Heinz (Canada). Edan imported this ketchup and sold it to various supermarket chains. Edan apparently labelled the ketchup as imported by them and added labelling information to comply with Canadian language laws. However, there is nothing in the Court's reasons that indicates that the labelling contained information that explicitly indicated to the Canadian consumers that this was an "American" formulation.

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[12] Federal Court Judgment: [1991] F.C.J. No. 143 (February 13, 1991). The discussion of the *Heinz* and *Nestlé* case below has been taken from Knopf (1991).

Heinz argued that the imported ketchup would likely cause confusion in Canada with the distinctly "Canadian" product and thereby severely depreciate the goodwill developed in the trademark. Further, it was argued that Edan was infringing Heinz Canada's exclusive use of the Heinz trademarks in Canada.

Heinz Canada apparently introduced a great deal of evidence to the effect that Heinz ketchup as made in the United States is different from that made in Canada. They did not allege that it is worse in quality, only different. Unfortunately, there are no details in the judgment as to the difference, only evidence that Heinz Canada spends a lot of money to keep abreast of changes in the tastes of the Canadian market. There was no discussion in the judgment of the spill-over effects into Canada of Heinz' advertising on television in the U.S..

Mr. Justice Cullen was also clearly struck by the fact that Heinz Canada is the major buyer of Canadian grown tomatoes, and that a lot of Canadian third parties, such as tomato farmers, could suffer irreparable harm if the injunction were not granted. It is not clear how this is relevant to the determination of an injunction application under the present *Trade Marks Act*.

Mr. Justice Cullen stated that this case is on all fours with *Remington-Rand*.[13] However, in that case the imported products came from a non-related German company. There is not a hint of discussion of the invalidity issue raised in so many other key cases such as *Breck's Sporting Goods v. Magder*.[14] It is understood this decision is being appealed.

Nestlé Enterprises Limited[15] is seeking an interim injunction to prevent Edan from importing from the U.S. and selling in Canada various brands of instant coffee. Nestlé Canada is a subsidiary of Nestlé Switzerland and a sister company of Nestle U.S.A.[16] Nestlé Canada is the registered owner of several trade-marks such as "Taster's Choice," "Nescafé," "Mountain Blend," etc. owned by Nestlé Switzerland. Nestlé US makes instant coffee and sells it in similar packages with identical trade-marks in the USA. It is said by the plaintiff to differ "markedly in composition, taste, appearance, and quality."[17]

This action is based upon a different legal footing than Heinz. Heinz alleged trade-mark infringement. Nestlé alleges statutory passing-off under the *Trade Marks Act*, by causing confusion (contrary of s.7(b)), passing off

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[13] *Remington Rand Limited v. Transworld Metal Company Limited* [1960] Exc. C.R. 463.

[14] *Breck's Sporting Goods v. Magder*, [1976] 1 S.C.R. 527.

[15] See *Nestlé Enterprises Limited v. Edan Food Sales Limited*, (Federal Court Trial Division, Action Number T-1109-91, Statement of Claim filed April 25, 1991).

[16] See affidavit of Fulvio Pagliaro, p. 5, q. 26.

[17] Para. 8, Statement of Claim, *supra* note 15.

(contrary to s.7(c)), and doing acts contrary to honest industrial usage (contrary to s.7(e)) of the *Trade Marks Act*. They appear to be taking the hint dropped by Estey, J. in the *Seiko*[18] case by bringing an action in this way. In *Seiko*, the Court noted that the manufacturer might well have been a plaintiff in that case in an action under the *Trade Marks Act*[19] as a registered user in Canada of the trade mark owned by the Japanese parent.[20] Even if the parent-manufacturer refused to join in the resulting action, the *Trade Marks Act* provides the distributor/registered user with a remedy in such a situation whereby it can proceed without the trade mark owner's consent.[21]

Of particular note is the fact that Edan has sought to invoke article 1808 of the Canada-U.S. *Free Trade Agreement* which deals with referrals of matters from judicial decisions. Edan appears to be seeking to force the Canadian and U.S. governments to state their views as to the meaning of the FTA on the matters in question.

5.4 Conclusions

This survey of the jurisprudence suggests that intellectual property rights, in some circumstances, can be used to bolster an international price discrimination strategy employed by the rights holder. However, it is unlikely that the property right commonly plays a critical role in such a strategy for the simple reason that the discriminator usually has better strategic alternatives. The best of these is the use of vertical restraints in the distribution system. The multinational intellectual property rights holder can place territorial restrictions on sales by its foreign subsidiaries. In most jurisdictions such territorial restrictions are legal, and assumedly because the restraint is imposed intra-firm, it can be monitored and enforced at relatively low cost when compared with litigation under intellectual property rights laws.

This concludes the discussion of potential abuses associated with exploitation of the exclusive privilege within a limited domain. The final set of potential abuses deals with the extension of the right in time and across markets.

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[18] *Consumers Distributing Company Limited v. Seiko Time Canada Limited* [1984] 1 S.C.R. 583.

[19] *Trade Marks Act*, R.S.C. 1970, c.T-10. There is also a broad hint at a trade marks action in the judgment.

[20] cf. *S.C. Johnson & Son Ltd. v. Marketing International Ltd.* (1980), 105 D.L.R. (3rd) 423.

[21] *Trade Marks Act*, R.S.C. 1970, c.T-10, s. 49(4). This particular point may be hinted at in the reference by Estey, J. to Fox (1972, pp. 440-441) in the judgment. Otherwise, the reference to copyright jurisprudence in this context is extremely difficult to understand.

6.0 EXTENSION OF THE PROPERTY RIGHT: POTENTIAL ABUSES AND ANTIDOTES

Extension of the intellectual property right beyond the grantee's immediate domain falls more comfortably within the conventional realm of competition policy. At issue is the extent to which the right holder can extend the exclusive privilege over time, and across both product and geographic markets. In this context potential abuses would include patent cartels, creation of entry barriers, patent pyramiding, and tying agreements. This section addresses two questions. First, how has Canadian competition policy dealt with such extensions of intellectual property rights? Second, is the current legislation adequate to deal with potential abuses?

6.1 The Jurisprudence

The Legislation: Section 32 of the *Competition Act*: The *Competition Act* explicitly addresses the issue of the abuse of intellectual property rights. A somewhat differently worded precursor to the current Section 32 of the *Act* was introduced into Canadian anti-combines legislation in 1910. Apparently the anti-competitive uses of patents were recognized very early in the evolution of competition policy. Section 32 stipulates that the Federal Court of Canada can act to remedy the situation,

> In any case where use has been made of the exclusive rights and privileges conferred by one or more patents for invention or by one or more trademarks or by a copyright so as
>
> (a) to limit unduly the facilities for transporting, producing, manufacturing, supplying, storing or dealing in any article or commodity which may be a subject of trade or commerce, or
>
> (b) to restrain or injure, unduly, trade or commerce in relation to any such article or commodity, or
>
> (c) to prevent, limit or lessen, unduly, the manufacture or production of any such article or commodity or unreasonably to enhance the price thereof, or
>
> (d) to prevent or lessen, unduly, competition in the production, manufacture, purchase, barter, sale, transportation or supply of any such article or commodity.

The remedies are far reaching and include voiding offensive agreements or licences, compelling the offender to licence the patent or copyright, revoking the patent, and directing that a trademark be expunged or amended.

The offensive behaviour set out in Section 32(a) through (d) is similar but not identical to the prohibited conduct included in the conspiracy provisions (S.45) of the *Act*.

Enforcement: It was not until 1967 that a case proceeded under the precursor to this section. In that year an information was filed against Union Carbide Canada Limited alleging that in licensing certain of its patents it had imposed restrictions which unduly lessened competition in the production of polyethylene resins and films.[22] Two groups of patents were eventually involved; three patents covered the air bubble extrusion process for producing polyethylene and other plastic films (the "extrusion patents") and two covered the process used for treating polyethylene and other thermoplastic films to make them ink adhesive for printing purposes (the "printing patents").

The 1967 case involved the extrusion patents. The material filed with the Court stated that Union Carbide held the extrusion patents and that Union Carbide and Canadian Industries Limited (CIL) were the only Canadian producers of the resin, which was not patented, used in the film making process. Union Carbide licensed twelve firms to produce the polyethylene film. The licensees paid no royalty as long as they purchased the resin from either Union Carbide or CIL. If they purchased imported resin a royalty was charged. Apparently the price of resin was some 30% higher in Canada than in the United States. Union Carbide dissuaded licensees from importing film produced by the patented extrusion process from the United States by threatening patent infringement litigation. It was also claimed that certain licensees were subjected to volume controls and restrictions on the size of their operations. One month after the Director referred the evidence to the Attorney General two of the three extrusion patents expired.

The case never went to trial as it was resolved with the filing of Minutes of Settlement in late 1969. Union Carbide undertook to release licensees from existing contracts and to offer royalty free licenses for the remaining patent. It further agreed not to restrict the importation of polyethylene film nor to control the volume of film produced by any licensee.

Three days after the filing of the Minutes of Settlement, the Attorney General filed an Information in the Federal Court against Union Carbide and five of the printing patents licensees. In the Information the primary allegation was that Union Carbide discriminated against small users by imposing a royalty schedule which declined with volume produced, and by restricting them to the production of certain types of products. The licenses included several other restrictive clauses. For example, licensees had to agree not to dispute the patents and to recognize the patent beyond the life of the grant. They also had to agree to grant back paid up licenses on any improvement patents they might obtain.

This case too was resolved without trial. Minutes of Settlement filed in 1971 included undertakings by Union Carbide to abandon the more restrictive elements in the licenses, including the volume based royalty system, restrictions on types of products licensees could produce, and the agreements to honour the patent beyond the life of the grant.

These two cases, neither of which went to trial, are the only proceedings under Section 32 of the *Competition Act*. Jurisprudence is scanty in this area.

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[22] See Director of Investigation and Research (1968, p. 42), (1970, pp. 54-56), (1971, p. 49), (1972, pp. 29-30), and Kaiser (1982).

Nevertheless, drawing from the terms of settlement it is possible to infer which practices the then Director found particularly offensive. These would include tying unpatented to patented products or processes, use of the patent to deter imports of both patented and unpatented goods, use of the patent to restrict the output or capacity of licensees, improvement grant-backs, agreements to honour the patent after expiry, and discriminatory licenses with respect to royalties and applications.

While these were the only cases under Section 32, an Information containing one count was laid under the old section 33 (monopoly) of the *Combines Investigation Act* in 1977 against Union Carbide and Canadian General Electric. Once again the issue was abuse of patents. Canadian General Electric held a patent on cross-linkable polyethylene compounds used as insulation on electrical wire and cable which it licensed to Union Carbide. The license required Union Carbide to sell only to customers who had a piece of machinery called a Banbury Mixer. The mixer was expensive and was used to coat wire with rubber, not polyethylene compounds. Only four companies possessed the qualifying mixer and it was alleged that these firms had a history of not competing with each other. Several other firms, who were reputed to compete on price, wanted supply of the polyethylene compound but did not qualify under the license. The Crown alleged that the mixer requirement was designed solely to exclude these "price cutters" from the market. The preliminary hearing concluded in December of 1978 and the accused were discharged three months later.[23]

In 1974 the then Senior Deputy Director of Investigation and Research, Mr. Roy Davidson (1974), identified licensing provisions which arguably have the effect of unreasonably extending the intellectual property right (hereafter these are referred to as the Davidson guidelines).

1. charging royalties on patents after they expire;
2. other restrictions, relating to the subject matter of the patent or to knowhow, which continue after the patent has expired;
3. the requirement that the licensee accept and pay for additional patents (to discourage a challenge to the validity of doubtful patents);
4. other tying arrangements such as the obligation to purchase capital goods or raw material from a designated source or to make permanent use of staff designated by the supplier of the technology;
5. obligations to use the distribution channels of the licensor or otherwise to restrict access to channels of distribution;
6. restrictions on exports, whether or not the products are protected by patents in other markets;
7. higher royalty charges on goods for export versus goods for the domestic market; and

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[23] *R.* v. *Canadian General Electric Company Limited and Union Carbide Canada Limited* (Provincial Court, Judicial District of York, March 9, 1979, unreported). See Director of Investigation and Research (1979, p. 34) and Kaiser (1982).

8. higher royalty charges to Canadian licensees than to licensees of the same patent owner in other markets.

Davidson (1974) went on to set out licensing conditions which tended to unreasonably entrench the property right.

1. restrictions requiring that the licensee not contest the validity of the patents involved;
2. restrictions on obtaining patents, know-how or trademarks from other companies with regard to the manufacture or sale of competing products (thus prohibiting the use of competing technology);
3. restrictions establishing a total or partial purchase option over the business of the licensee in favour of the supplier;
4. restrictions requiring the transfer of any inventions or improvements to the licensor;
5. cross-licensing which has the effect of reinforcing a tight oligopoly;
6. field-of-use restrictions, restrictions on the level of production, price fixing, and allocation of exclusive territories which may have the effect of buying off the most likely challengers to the patent holder, who otherwise invent around the patent or upset its validity, by ensuring the monopoly gains will be shared.

6.2 Potential Antidotes to Anti-Competitive Abuses

Without a rich jurisprudence it is difficult to identify with precision the capacity of Canadian competition policy to deal with specific anti-competitive practices associated with the intellectual property rights systems. Therefore, in this section anti-competitive practices are identified, and potential competition policy antidotes discussed.

Horizontal Combination: There is a competition policy concern that intellectual property rights can be used as a nucleus around which conspiracies in restraint of trade are formed. The danger is two-fold. First, the exchange of intellectual property rights between competing enterprises can provide a forum for the discussion of price and market sharing agreements. Second the terms of exchange (e.g., cross-licensing and pooling contract) can provide an efficient mechanism for enforcing broad, restrictive agreements. These concerns are most evident with respect to patents.

The licensing of patent rights commonly involves contractual agreements between direct competitors. A first question is whether the licensor has the right to impose price and quantity restraints on the licensee which restrict competition between them? From a simplistic perspective such contractual conditions should not of course be necessary. If there are monopoly rents to be extracted from the patent, the licensor should be able to extract all of them through royalties without having to dictate to the licensee where or at what price to sell. Generally, because the licensee must bear royalty charges it will have higher costs than the patentee. In the assumedly rare case where the patentee is extremely inefficient but insists on producing, the setting of minimum prices might have negative welfare effects. In any case, such price and quantity constraints are common, and were they forbidden the result would probably be a sharp reduction in licensing with no clear positive welfare result.

The question of the legality of such price and quantity restraints was resolved early on in United States antitrust jurisprudence. The doctrine set out in the 1926 *General Electric* case established that where a single patentee licensed a single patent to a few firms it had the right to set the price at which the licensees could sell.

> ...If the patentee goes further and licenses the selling of the articles, may he limit the selling by limiting the method of sale and the price? We think he may do so provided the conditions of sale are normally and reasonably adapted to secure pecuniary reward for the patentee's monopoly.... It would seem entirely reasonable the (patentee) should say to the licensee, "Yes, you may make and sell articles under my patent but not so as to destroy the profit that I wish to obtain by making them and selling them myself."[24]

However, in the *Hartford-Empire* case the United States Supreme Court made it clear that when the patent holder acts in concert with others through pooling and cross-licensing arrangements to limit competition between them, this runs counter to the *Sherman Act*.[25] The case involved the cross-licensing of more than 800 patents concerning the machinery for producing glass containers. Ultimately, over 94% of all glass containers were produced on machines using one or more of the pooled patents.

In summary, under United States antitrust law a single holder of a patent can, up to a point, impose price and quantity restrictions on its licensees. These restrictions cannot be carried to the point where all competition between licensees is extinguished. Cross-licensing and patent pooling are allowed as long as the agreements are not used to eliminate competition between the patentees and licensees.

In Canada, horizontal agreements involving patents, copyright and trademarks come under the ambit of Section 32 of the *Competition Act*. This point was made forcefully in the 1945 *Report of the Commissioner on Canada and International Cartels*.

> If the members of a patent pool have agreed to eliminate competition between themselves, as by restricting production or fixing prices, and have proceeded to carry it out by such ways as inserting restrictive conditions to that effect in the reciprocal permissions, or cross-licenses, to use one another's inventions or by seeing that the holding company to which each has transferred his patents inserts similar conditions in the licenses it gives back to each member, the agreement is in no basic way different from any other agreement to eliminate competition, and is punishable as such when against the public interest.

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[24] *United States* v. *General Electric Company*, 272 U.S. 476 (1926), pp. 489-490.

[25] *Hartford-Empire* v. *United States*, 323 U.S. 386 (1945).

> This was pointed out in the debate on the *Act* in the House of Commons on April 5, 1937, and in the judgments of the Exchequer Court and the Supreme Court of Canada in the *Thermionics* case [1939 D.L.R. at 135; 1943 D.L.R. at 458]. If the agreement itself offends against the *Combines Act* the fact that it is carried on, and perhaps rendered more easily carried on, by means of patent machinery is irrelevant (Commissioner, *Combines Investigation Act*, 1945, p. 52).

Recall that in the Union Carbide proceedings involving extrusion patents the Director challenged licensing restrictions which controlled the volume of film produced by licensees, and that Union Carbide subsequently undertook to abandon this practice. In fact, this type of restriction which involved only one patent, and one patent holder, might well have not been challenged under United States jurisprudence. Recall further that the Davidson guidelines suggest that the Director would view unfavourably cross-licensing which would have the effect of reinforcing a tight oligopoly and use, volume, price and territorial restrictions which would have the effect of "buying off" potential entrants. In short, legislation has long been in place for prosecuting horizontal combinations facilitated by intellectual property rights.

However, there has been a dearth of prosecutions of collusive arrangements involving intellectual property rights. This can be explained by a lack of vigilance or by the infrequency of violations. The relevance of the former explanation is not addressed here, but there are arguments to support the latter. First, patents are of limited economic significance in most industries. Trademarks, while more ubiquitous, are less likely to serve as the base for a collusive arrangement (e.g., "trademark pools" and the cross-licensing of trademarks are rare). Second, there are other arrangements such as joint ventures and partial equity agreements that are likely to be far more potent instruments for effecting agreements to coordinate prices and to stabilize market shares (see Reynolds and Snapp, 1982). In this regard, R & D joint ventures are becoming increasingly prominent in a number of industries (Teece, 1987). Such joint ventures are presumably facilitated in Canada by section 45(3)(e) which exempts agreements relating to cooperation in R & D from the conspiracy provisions of the *Competition Act*.

Before leaving the topic of horizontal combination, it is useful to review proposed changes to the *Copyright Act* which bear upon the issue. Copyright by its nature confers some degree of monopoly power, but since copyrighted works compete directly with each other, the degree of monopoly will be limited in many cases (Smith, 1988). Where copyright royalties are negotiated and distributed through collectives, there is a significant threat that such collectives will exercise monopoly power.[26] The major Canadian collectives established to negotiate, collect and distribute royalties to composers and authors of copyright music, as well as domestic publishers involved, are the

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[26] A collective is an organization designed to administer some of the rights conferred by the *Copyright Act* on a collective basis.

Composer, Authors and Publishers Association of Canada (CAPAC) and the Performing Rights Organization of Canada (PROCAN). These performing rights societies collect performing rights royalties primarily from radio and television broadcasters.

Under the proposed Part 2 amendments to the *Copyright Act*, new rights granted will likely lead to the growth of additional collectives. The two major amendments in this regard are a performing right for Canadian performers which would extend copyright protection to performers for re-use of material they have recorded when the material is part of a subsequent broadcast, and a performing right for sound recordings which would extend copyright protection to record companies when their recorded music is played by radio stations.[27] Royalty payments under a performer's right would flow primarily from broadcasters to a new performers' collective most likely consisting of the leading performers' unions in Canada.[28] It is unclear at present how the record companies will organize themselves for purposes of collecting royalties under the sound recording right. One possibility is that record companies will join the existing collectives of composers and music publishers.

The Copyright Appeal Board (CAB) is the body designated to deal with the potential market power aspects of collectives. Specifically, the CAB approves tariffs proposed by the music performing rights societies. Hence, direct users of copyrighted music who negotiate with the collectives can presumably voice their concerns about the collectives' exercise of market power to the CAB. Presumably any new collectives will be regulated in the same way by the CAB.

In principle, the CAB can play the role of competition policy authority with respect to the activities of collectives. In practice, it is unclear whether it is capable and willing to evaluate the activities of collectives within the broader domain of abuse of a dominant position. For example, proposed tariffs may be seen by the CAB as being "fair," although they may be designed partly to restrict the entry of new competing collectives or the growth of existing rival collectives, or (indeed) of individual copyright holders who are seeking to negotiate and collect royalty payments on an individual basis. Since collectives are protected by the existence of the CAB from the scrutiny of competition policy, there is a risk that preemptive behaviour by collectives may not be adequately addressed, unless direct users of copyright material are diligent protectors of their long-run positions as consumers, and the CAB's considerations extend beyond the narrow issue of "fairness" in evaluating tariffs.[29] The willingness of the CAB to address broad competition issues might soon be tested by the proposed merger of the two major collectives, PROCAN and CAPAC.

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[27] These amendments are described in Smith (1988). It is also likely that collectives will be established to expedite provisions for photocopying fees and retransmission fees paid by cable companies to program copyright holders.

[28] These are the American Federation of Musicians, the Association of Canadian Television and Radio Artists and the Union des Artistes.

Preemptive Behaviour: Preemptive behaviour refers to strategies to deter the market entry of competitors. An intellectual property right holder might adopt strategies to curb the supply of substitute goods during the life of a property right, to extend the life of the right, or both.

In the case of patents, concern has been raised about the incentive for firms to accumulate patents, sometimes called "patent pyramiding" or "fencing-in" a technology, in order to raise the costs of entry into their lines of business. This type of patenting strategy is seen as preemptive behaviour comparable to investing in physical capacity or launching new product brands. The incumbent firm incurs sunk costs which oblige would-be entrants to incur increased expenses in order to stay on the technological frontier. Potential entrants are obliged to spend more in order to 'patent-around' the incumbent's protected patent position. The assumption is that the incumbent will patent all the low-cost new technological approaches leaving potential entrants to tackle the higher cost and less promising alternative technologies. The preemption strategy could be carried forward in time by including in patent licenses 'grant-back' improvement clauses and clauses to honour the patent after expiry. As Gilbert (1981) notes, if preemption keeps competitors off the frontier of technical progress, the strategy could create a barrier to entry as competitors' costs of product development and production exceed those of the dominant firm. As the cost gap increases, the dominant firm can reduce expenditures on R&D with a lower risk of encouraging entry. However, he argues that in view of the very limited monopoly power afforded by patents in most industries, preemptive patenting could occur only in exceptional circumstances. Given the concentration of patents in a few industries in Canada, preemptive patenting cannot be a widespread problem.

Similarly, there is an argument that trademarks can serve preemptive strategies. Heavy advertising on a trademarked product or service, particularly when combined with a first mover advantage, can serve to increase the costs of entry.

Historically, Canadian competition policy has paid passing attention to the use of intellectual property rights to enhance a preemptive strategy. The *Union Carbide* case involving printing patents did address the issue of licensing clauses which required the honouring of patents after expiry. The Davidson (1974) guidelines did make reference to "grant-backs," restrictions requiring licensees not to contest the patents and not to purchase patents, know-how or trademarks for substitute goods. However, there is little jurisprudence beyond this.

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29. Whether the CAB has the capability to examine arguments surrounding issues of strategic economic behaviour such as entry preemption and predation is another question.

With the passage of the *Competition Act* preemptive behaviour may be addressable through the "Abuse of Dominant Position" provisions in sections 78 and 79. The *Act* explicitly identifies a number of practices as constituting abuses of a dominant position without restricting the generality of the term. The practices explicitly cited include:

(a) vertical price squeezing
(b) preemptive acquisition of a customer
(c) freight equalization on the plant of customer
(d) use of fighting brands
(e) preemption of scarce facilities or resources
(f) buying up products to prevent price erosion
(g) adoption of restrictive product specifications
(h) inducing a supplier to restrict sales to specific customers
(i) predatory pricing

Section 79(5) of the *Act* allows that the exercise of an intellectual property right constitutes a defence against the allegation of abuse of a dominant position:

> For the purpose of this section an act engaged in pursuant only to the exercise of any right or enjoyment of any interest derived under the *Copyright Act*, *Industrial Design Act*, *Patent Act*, *Trade Marks Act* or any other Act of Parliament, pertaining to intellectual or industrial property is not an anti-competitive act.

However, as Anderson and Khosla (1987, p. 55) point out, Section 79(5) does not provide a blanket exemption for intellectual property rights holders.

> The phrase "pursuant only to the exercise [of such rights]" suggests that section 79 remains applicable to the use of intellectual property rights in ways which go beyond the purposes contemplated in the statutes. Thus, the language of subsection 79(5) arguably permits the application of section 79 to a broad range of acts considered to be abuses of intellectual property rights.

There is, at the time of this writing, a case before the Competition Tribunal wherein the Director alleges abuse of a dominant position in the market for aspartame.[30] The company, NutraSweet, is alleged, *inter alia*, to be practicing predatory pricing, tying up customers (who otherwise would make some portion of their business available to rivals) through exclusive supply contracts, and providing discounts to customers who forgo using rival brands of intense sweeteners. While patent protection for the aspartame product expired in the summer of 1987, NutraSweet holds process patents that are still in force in Canada. The latter are not identified as a significant feature of NutraSweet's abuse of a dominant position. However, the NutraSweet trademark (i.e., the "Swirl" logo) is cited as being an important instrument facilitating anti-competitive behaviour. Specifically, NutraSweet is alleged to offer price discounts to customers who display the Swirl on their packaging. If the Swirl is displayed, customers cannot use other brands of aspartame. Hence, obtaining the so-called trademark allowance is indirectly conditional upon exclusive use of the NutraSweet brand aspartame.

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[30] "Application Before the Competition Tribunal Between the Director of Investigation and Research, Applicant, and The NutraSweet Company, Respondent," January 1990. See also *Canadian Competition Policy Record*, Vol. 10(2), 1989, pp. 4-8; Vol. 10(4), 1989, pp. 11-12 and (1990) 32 C.P.R. (3d) 1 for the Competition Tribunal's decision in *NutraSweet* in favour of the Director. It is under appeal.

By bringing this case the Director has shown that the mere possession of a trademark, or some other protected intellectual property asset, does not exempt anti-competitive behaviour from his scrutiny under Section 79, even when the behaviour is directly or indirectly expedited by that asset. However, until a decision is rendered by the Tribunal in the *NutraSweet* case, it is unclear what limits exist under the *Act* to exercising an intellectual property right or to otherwise exploiting commercial assets protected by intellectual property legislation.

Given the generality of the abuse provision, it would seem that there is ample scope for the Tribunal to address any specific strategic behaviour intended to preempt a rival. In this context, strategic entry deterrence may be thought of as actions undertaken by an incumbent dominant firm to maintain its position or slow the rate at which it loses its dominant market share to new competitors. This is achieved by increasing the perceived costs and risks of entry or (equivalently) by reducing rivals' perceptions of post-entry profitability.[31] As noted in the *NutraSweet* case, patents and trademarks might figure directly or indirectly in an entry deterrence strategy.[32]

It appears that when the primary effect of the exercise of an intellectual property right is to discourage entry rather than lowering real economic costs or otherwise enhancing consumer welfare, such behaviour could be viewed as an abuse of a dominant position. To be sure, the conditions under which such behaviour is likely to be more profitable for the incumbent are relatively limited. For one thing, patents are not a very significant barrier to entry in most industries. For another it will often be more profitable for the incumbent to buy out a rival's competing technology than to engage in abusive behaviour to deter entry.

Extension of Rights to Other Markets: It is currently unfashionable to give credence to arguments that monopolists benefit by "levering" market power from one market to another, and it is currently fashionable to presume efficiency rationales for most vertical restraints. Be that as it may, it is common to find examples where intellectual property rights play a role both in apparent attempts to lever market power, and in restrictive vertical practices unexplained by efficiency rationales. Furthermore, since legislation is in place dealing with these issues they warrant attention.

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[31] A discussion of strategic deterrence behaviour in this frame of reference can be found in Jacquemin (1987).

[32] Given the wide range of substitutes available for any asset protected by copyright, it is unlikely that any holder of a copyright would meet the criterion of market dominance required for application of S.79 of the *Competition Act*.

Tying: A tying arrangement exists when a seller offers one product or service (the tying product) on the condition that the buyer also purchase one or more other products or services (the tied product). Tying raises two competition policy issues. First, such practices facilitate levering the market power attributable to the tying product on to the tied product. Second, tying can increase barriers to entry to the supply of the tied product.

The United States Supreme Court summarized the law on tying arrangements for situations where patents were not involved in the *Northern Pacific* case.

> Where such conditions [tying arrangements] are successfully exacted competition on the merits with respect to the tied product is inevitably curbed. Indeed "tying agreements serve hardly any purpose beyond the suppression of competition".... They are unreasonable in and of themselves whenever a party has sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product and a "not insubstantial" amount of interstate commerce is affected.[33]

The *Northern Pacific* decision set out the criteria for a finding of illegality in United States tying cases. First, the tied and tying products had to be separable and distinct. Second, the party had to have sufficient market power in the tying product market to appreciably affect competition in the market for the tied product. Third, the tying arrangements had to affect a significant amount of commerce. However as a result of the *Loew's* case, satisfaction of the second criterion (sufficient market power) was automatically assumed when the tying product was protected by patent or copyright.

> Market dominance--some power to control price and to exclude competition--is by no means the only test of whether the seller has the requisite economic power. Even absent a showing of market dominance, the crucial economic power may be inferred from the tying product's desirability to consumers or from uniqueness in its attributes.... The requisite economic power is presumed when the tying product is patented or copyrighted...[34]

Since the *Leow's* decision the United States Supreme Court has not reviewed a tying case where the tying product was protected by intellectual property rights. While there is growing criticism by both economists and the legal profession over the presumption of market power conferred by patent and copyright set out in *Loew's*, that decision still stands.[35] In effect, conditioning the sale of a patented or copyrighted product on the purchase of another product is a *per se* antitrust violation in the United States.

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[33] *Northern Pacific Railway Co.* v. *United States*, 356 U.S. 1 (1957) pp. 5-6.

[34] *United States* v. *Loew's Inc.* 371 U.S. 38 (1962), p. 45.

There are few Canadian precedents dealing with tying arrangements, and no decisions on the use of patented, copyrighted or trademarked goods as the tying product. In the Union Carbide extrusion patents case, the patent license did tie the licensee to purchases of resin from either the patentee or CIL, and the elimination of this tie-in was a part of the Minutes of Settlement. Also, the Davidson guidelines suggest that tie-ins involving patents were unreasonable with no reference to the market power of the patentee.

Given the wording of Section 77(2) of the *Competition Act*, the question of whether intellectual property rights lead to a presumption of market power is relevant to Canadian law bearing on tying arrangements.

> Where, on application by the Director, the Tribunal finds that exclusive dealing or tied selling, because it is engaged in by a major supplier of a product in a market or because it is widespread in a market, is likely to
>
> (a) impede entry into or expansion of a firm in the market,
> (b) impede introduction of a product into or expansion of sales of a product in the market, or
> (c) have any other exclusionary effect in the market,
>
> with the result that competition is or is likely to be lessened substantially, the Tribunal may make an order....

The issue is whether the Competition Tribunal will follow United States jurisprudence in presuming that an intellectual property right holder is automatically "a major supplier of a product in a market." If it does, the use of a protected tying product will be *per se* illegal. If the Tribunal rejects this presumption it will be up to the Crown to show that the protected product has no close substitutes and therefore occupies a market unto itself.

Before leaving the subject of tying arrangements it is interesting to note several exemptions relating uniquely to intellectual property rights. Section 77 explicitly exempts arrangements between affiliated parties. At subsection (5a) parties are defined as affiliated if,

> one party grants to another the right to use a trade mark or trade name to identify the business of the grantee, if (i) the business is related to the sale or distribution, pursuant to a marketing plan or system prescribed substantially by the grantor, of a multiplicity of products obtained from competing sources of supply and a multiplicity of suppliers....

This has been called the "Canadian Tire amendment" as it prevents the application of orders in respect of exclusive dealing, market restrictions or tied selling to multiple product "franchise" operations such as Canadian Tire, Shoppers Drug Mart and others (Stanbury, 1977, pp. 182-183).

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[35] See Brinson (1987) and Lavey (1982).

Subsection (6) states that when there is,

> an agreement whereby one person (the "first" person) supplies or causes to be supplied to another person (the "second" person) an ingredient or ingredients that the second person processes by the addition of labour and material into an article of food or drink that he then sells in association with a trade mark that the first person owns or in respect of which the first person is a registered user, the first person and the second person are deemed, in respect of the agreement to be affiliated.

This exempts agreements involving franchise bottlers and franchise food outlets. Apparently the pressure for this amendment, referred to as "the bottlers' amendment," came from the Canadian Soft Drink Bottlers' Association (Stanbury, 1977, pp. 182-183).

Resale Price Maintenance: Under the *Competition Act*, resale price maintenance remains *per se* illegal in Canada.[36] Section 61 explicitly stipulates that no exception is to be made for intellectual property rights holders.

> No person who is engaged in the business of producing or supplying a product, or who extends credit by way of credit cards or is otherwise engaged in a business that relates to credit cards, or who has the exclusive rights and privileges conferred by a patent, trade mark, copyright or registered industrial design shall, directly or indirectly
>
> > (a) by agreement, threat, promise or any like means, attempt to influence upward, or to discourage the reduction of, the price at which any other person engaged in business in Canada supplies or offers to supply or advertises a product within Canada...

Refusal to Deal: A successful application under S.75 requires that the government show that a person is substantially affected in his business because he is denied supply of a "product," the "product" is in ample supply and he is willing to meet the usual trade terms. Subsection (2) provides the following defence.

> For the purposes of this section, an article is not a separate product in a market only because it is differentiated from other articles in its class by a trade mark, proprietary name or the like, unless the article so differentiated occupies such a dominant position in the market as to substantially affect the ability of a person to carry on business....

In other words, a trademarked article cannot itself be the market unless it holds a dominant position. This defence, like the tied sales provisions, raises the issue of the relationship between intellectual property rights and market power. In a recent Section 77 case the Competition Tribunal (1989, p. 17) defined the "product" as Chrysler auto parts. Its reasoning was as follows.

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[36] See Stanley Wong, "The Law of Price Maintenance in Canada: Review and Assessment" in Part 5 of this volume.

> The product is Chrysler auto parts not "only because it is differentiated from the other articles in its class by a trade mark, proprietary name or the like." It is not only the existence of the trademark that determines the definition but rather the demand of Brunet's customers. Subsection 75(2) forecloses reliance being placed on trademarks (save for the specified exception) to define products in spite of the existence of acceptable substitutes to customers. This factor, the presence or absence of acceptable substitutes to customers, is of paramount importance in arriving at the appropriate definition of the "product" and was the determining factor in the present case.

In matters of trademark the Tribunal will not accept a presumption of market power for the purposes of the refusal to deal provisions of the *Act*. It has clearly stated that the appropriate test is the availability of acceptable substitutes. How it will deal with the other intellectual property rights, particularly patent and copyright, remains to be seen.

Private Enforcement: Nearly 45 years ago, H.G. Fox (1946, p. 340), for a long time the recognized authority on Canadian patent law, supported his thesis that anti-competitive patent abuses were rare by noting that only once had such an abuse been used as a defence in an infringement case.

> The *Combines Investigation Act* and its predecessors have been on the statute books for about forty years. In all that time only in one action for patent infringement has the defence of illegal combines been put forward and considered by any court in Canada, and the defence was unsuccessful. No action has ever been brought to have a patent revoked because it was used as the basis of an illegal combine. If the mischiefs against which the *Combines Investigation Act* purports to provide a remedy are in any measure a part of our commercial life, it seems passing strange that in all those years the defence has been evoked but once–and defendants in patent suits are neither reluctant nor coy in putting forth every defence that has any possible chance of success.

The litigation in question was the *Thermionics* case. Philco Products Ltd. defended itself against infringement of Thermionics' patents in part on the basis of the following argument.

> ...the patents in suit are invalid because they were given for an illegal consideration, having been made in pursuance, or as a result of an agreement between or among the plaintiffs or some of them, whereby the said plaintiffs fix, control and unreasonably enhance the prices at which radio tubes are sold to dealers in and users of the said tubes, thereby restricting competition and detrimentally affecting the public, all of which is contrary to the provision of the *Combines Investigation Act*....[37]

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[37] *Philco Products Ltd.* v. *Thermionics Ltd.*, [1943] 3 D.L.R., at p. 455.

The defence failed because the Supreme Court concluded that the combine did not affect title and thus there was no basis for forfeiture of the patent rights. In effect, if the patent holder does not rely upon an illegal agreement to claim title to the patent, then the existence of an illegal agreement does not threaten his ownership of the patent. Presumably if a patentee enters an illegal cartel, the patent right is not jeopardized. However, if a supplier obtains patent rights through an illegal cartel the rights would be contestable.

The precedent set out in *Thermionics* has subsequently been applied to both copyright and industrial design (see Kaiser, 1982, pp. 12-6 to 12-8). More recently it has been held at the interlocutory stage of a patent infringement action that a defence could be based on the argument that the plaintiff had come to the Court with "unclean hands" in that it had offended the *Combines Investigation Act* and should therefore be refused equitable relief.[38] Notwithstanding this somewhat broader interpretation of the scope of the defence, there is little to suggest that private actions will play much of a role in the control of anti-competitive abuses of intellectual property rights.

7.0 CONCLUSIONS

The intellectual property rights legislation in combination with the *Competition Act*, appear adequate to deal with most potentially anti-competitive abuses. One possible exception is the use of these rights in international price discrimination strategies. The recent experience in the United States suggests that the practice is not uncommon. Eventually, Canadian jurisprudence will have to confront this issue.

Overall, the abuse of intellectual property rights is probably not widespread, mainly because such rights are important only in a limited set of industries. Further, competition policy remedies do exist. However, the mere existence of statutes cannot assure control of abuses. The sparseness of case law in the area can be attributed to a lack of a problem, or to a lack of enforcement.

This conclusion does not differ substantially from that reached by I.M. MacKeigan (1946) nearly 45 years ago.

> The primary purpose of this memorandum is not to show or claim that patents have been abused in Canada. No one can say definitely to what extent abuses exist until we know a great deal more about the facts than we yet know. Neither, however, can anyone prove, without that greater knowledge, that such abuses do not exist or may not exist in future. Certainly such proof is not supplied by arguments based merely on the legislative provisions examined above.

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[38] See *Hughes and Woodley on Patents* (Scarborough, Ontario: Butterworth) Issue 11, 4/89, pp. 320-321.

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Table 1

Concentration of Canadian Patents by Sector, 1984/85

Sector	Percent of All Product Patents
Electrical Products	22.8
Machinery	18.6
Chemical Products	16.7
Scientific and Professional Equipment	6.9
Fabricated Metals	5.8
Transportation Equipment	3.6

Source: PATDAT series

Table 2

Percent of Inventions That Would Not Have Been Developed or Commercially Introduced Without Patent Protection, 1981-1983

Industry	Percent that would not have been introduced	Percent that would not have been developed
Pharmaceutical	65	60
Chemicals	30	38
Petroleum	18	25
Machinery	15	17
Fabricated metal prod.	12	12
Primary metals	8	1
Electrical equipment	4	11
Instruments	1	1
Office equipment	0	0
Motor vehicles	0	0
Rubber	0	0
Textiles	0	0

Source: Mansfield (1986, p. 175).

Chapter 23

THE COMPETITION POLICY TREATMENT OF INTELLECTUAL PROPERTY RIGHTS IN CANADA: RETROSPECT AND PROSPECT

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1.0 INTRODUCTION

Intellectual property rights (IPRs) have long been an important focus of interest on the part of competition policy authorities in Canada and abroad. In the past, there were extensive efforts by such authorities to constrain the exercise of IPRs through strict application of competition laws. In Canada, there were also several attempts by competition advocates to strengthen existing legislative remedies applicable to abuse of IPRs.[1] Recently, however, competition authorities have increasingly accepted the beneficial functions of IPRs and have even participated in efforts to facilitate the legitimate exercise of such rights.[2]

The evolution in competition policies respecting intellectual property reflects important underlying developments in antitrust thought. In the 1960s and 1970s, IPRs were widely viewed as "statutory monopolies" - a form of necessary evil that could easily impose excessive costs on consumers.[3] In the 1980s, however, IPRs were increasingly seen as merely another form of property rights, serving useful, pro-competitive functions in a market economy. This change in perspective was not limited to Canada and, indeed, was most noticeable in the U.S., which previously had employed its antitrust laws to strictly constrain the use of IPRs.[4]

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[*]. The views expressed in this paper are the authors' and not necessarily those of the Bureau. The authors are grateful to William L. Hayhurst and Bruce C. McDonald for helpful comments on an earlier version of the paper.

[1] For details, see Part 3.0, below.

[2] See, e.g., the discussion of the competition policy input to the 1988 *Copyright Act* amendments in Part 4.0, below.

The new competition policy perspective towards IPRs is based, in part, on greater appreciation of the dynamic aspects of competition relating to innovation and adaptation of new technology. In this context, the role of intellectual property in fostering inventive activity is seen as contributing directly to competition and consumer welfare.[5] In addition, the role of intellectual property rights (like other property rights) in facilitating efficient transactions is increasingly recognized.[6]

The generally diminished concern about anti-competitive effects of IPRs also reflects improved understanding of the economic implications of associated trade practices such as tied selling, field-of-use restrictions and other vertical market restraints. Whereas in the past, these practices were widely viewed as inherently anti-competitive, most antitrust scholars now accept that in many cases they serve important pro-competitive functions. The key to this understanding is the distinction that is currently drawn between the effects of these practices on intrabrand competition (i.e., competition within an individual product brand) and interbrand competition (i.e., competition between alternative brands). By limiting inefficient, intrabrand competition, vertical market restraints can actually enhance interbrand competition.[7]

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[3] See, e.g., Donald F. Turner, "The Patent System and Competitive Policy," *New York University Law Review*, vol. 44, 1969. In Canada, as recently as 1976, a Working Paper of the Department of Consumer and Corporate Affairs recommended "that Canada give serious consideration to the possibility of abandoning the continued maintenance of a patent system in any form," based on competition and other economic policy considerations. See Consumer and Corporate Affairs Canada, *Working Paper on Patent Law Revision* (Ottawa: Supply and Services Canada, 1976), at p. 92. For a classic sceptical analysis of the benefits of patents, see Fritz Machlup, *An Economic Review of the Patent System* (Study No. 15 for the U.S. Senate, Subcommittee on Patents, Trademarks and Copyrights, 85th. Cong., 2nd. Sess., 1958).

[4] See the strictures laid down in Bruce Wilson [U.S. Department of Justice], *Law on Licensing Practices: Myth or Reality* (Notes for an Address, January 21, 1975). Mr. Wilson's strictures quickly became known as the "Nine No-Nos" of licensing in the U.S.

[5] See, generally, F.M. Scherer, *Industrial Market Structure and Economic Performance* (Boston: Houghton Mifflin Company, 1980, second edition), ch. 15 and references cited therein.

[6] J. Paul McGrath [then Associate U.S. Attorney General for Antitrust], "Patent Licensing: A Fresh Look at Antitrust Principles in a Changing Economic Environment," *Patent and Trademark Review*, vol. 82, no. 9, September 1984, pp. 355-65.

The limited modifications in Canadian competition legislation applicable to intellectual property rights during the 1980s reflected this revised competition policy perspective towards IPRs. This approach was also reflected in competition policy related aspects of the 1987 amendments to the *Patent Act* and 1988 amendments to the *Copyright Act*. In the U.S., the change in perspective led to a dramatic reversal of previous statements by the Department of Justice concerning its enforcement policies respecting intellectual property licensing.[8]

In the 1990s, the limits of the current thinking concerning the pro-competitive impact of IPRs are likely to be tested. Modern technology has given rise to new species of intellectual property such as semiconductor chip designs and computer software.[9] The future growth prospects of Canada and other countries increasingly depend on successful development and adaptation of such advanced technology.[10] In addition, with the globalization of markets, concerns have been expressed regarding the impact of IPRs and related licensing practices on international trade and technology transfer.[11]

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[7] For an overview of conceptual developments relating to vertical restraints, see G.F. Mathewson and R. Winter, *Competition Policy and Vertical Exchange* (Toronto: University of Toronto Press for the Royal Commission on the Economic Union and Development Prospects for Canada, 1985) and Frank H. Easterbrook, "Vertical Arrangements and the Rule of Reason," *Antitrust Law Journal*, vol. 5.3, Issue 1, 1984, pp. 135-73. The new appreciation of the potential efficiency benefits of vertical restraints in connection with intellectual property was first developed extensively in Ward S. Bowman, *Patent and Antitrust Law* (Chicago: University of Chicago Press, 1973).

[8] In 1986, Charles F. Rule, former U.S. Deputy Assistant Attorney General for Antitrust, stated as follows: "Patents - and our recognition and protection of them - do not conflict with the antitrust laws, at their interface or anywhere else.... In the great majority of cases, [the benefits of restrictive patent licensing practices] will outweigh any anti-competitive threat.... The past paranoia [on the part of the U.S. Department of Justice and others] about patents and other intellectual property was unwarranted and irrational." Charles F. Rule, *The Antitrust Implications of International Licensing: After the Nine No-Nos* (Remarks before the Legal Conference of the World Trade Association and the Cincinnatti Patent Law Association, October 21, 1986).

[9] Legislation to establish intellectual property protection for semiconductor chip designs and plant breeders' rights in Canada was introduced in the House of Commons in 1989.

[10] For pertinent discussion, see Consumer and Corporate Affairs Canada, *Intellectual Property and Canada's Commercial Interests: A Summary Report* (Ottawa: Minister of Supply and Services, 1990). See also Economic Council of Canada, *The Bottom Line: Technology, Trade and Income Growth* (Ottawa: Supply and Services Canada, 1984).

[11] For discussion, see J.P. Palmer and R.J. Aiello, "International Technology Exchange: An Economic Analysis of Legal Proposals," in John J. Quinn, ed., *The International Legal Environment* (Toronto: University of Toronto Press for the Royal Commission on the Economic Union and Development Prospects for Canada, 1986), pp. 239-270.

Continued territorial market limitations resulting from IPRs may be viewed as inconsistent with the general trend toward freer movement of goods, services and capital across international boundaries.

This paper provides an analytical survey of these developments. Part 2 reviews historical developments concerning the competition policy treatment of intellectual property rights in Canada in the period from 1910 to 1950. Part 3 considers the major efforts by competition advocates to constrain the exercise of IPRs during the period from 1950 to 1980. Part 4 of the paper discusses the legislative and policy refinements of the 1980s which reflect the new competition policy perspective towards IPRs. Part 5 focuses on competition policy-intellectual property issues for the 1990s. Part 6 provides concluding remarks.

2.0 EARLY LEGISLATIVE AND JURISPRUDENTIAL DEVELOPMENTS (1910-1950)

The years 1910 to 1950 were a formulative period for the competition policy treatment of IPRs in Canada. The perceived anti-competitive abuse of patents was an important concern of policy-makers throughout this period. The statutory remedies and other provisions adopted during this period formed the basis for some of the key provisions of the present *Competition Act* relating to IPRs. The 1910 to 1950 period also witnessed important case law developments regarding the constitutional underpinnings of the patent remedy provisions in the *Combines Investigation Act* and the scope for consideration of alleged anti-competitive abuses in private intellectual property suits.

2.1 The Enactment of the Patent Remedy Provisions in the Combines Investigation Act of 1910

The initial concerns on the part of Canadian policy-makers regarding anti-competitive abuse of IPRs were based to a large extent on the operations of the United Shoe Machinery Company. In the early 1900s, the Company obtained a dominant position in the North American shoe machinery market through mergers and acquisitions as well as the accumulation of patents "covering every shadow of a shade in the parts of the many machines used in the manufacture of shoes."[12] The Company also attempted to reinforce its dominance through restrictive leasing practices including tying provisions and automatic renewal of long-term leases. In the U.S., these actions resulted in one of the classic early prosecutions under section 2 of the *Sherman Act*, the *United Shoe Machinery* case.[13]

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[12] *U.S.* v. *United Shoe Machinery Co. of N.J.*, 223 U.S. Federal Antitrust Decisions 1917-1920 (U.S. Sup. Ct.: 1918), p. 272. Also see "The Combines Investigation Act, 1910 - United Shoe Machinery Company Case," *The Labour Gazette*, November 1912, pp. 464-476, p. 468.

In Canada, a challenge to United's restrictive leasing provisions in the case of *United Shoe Machinery Company of Canada* v. *Brunet* provided the impetus for the development of the first patent remedy provisions in the *Combines Investigation Act* of 1910.[14] In this case, the defendant claimed, as a defence for breach of the tying provisions in United's leases, that these and other restrictive provisions contained in the leases were in violation of the common law doctrine on restraint of trade. The courts, reflecting a traditional reluctance to interfere with freely negotiated contractual arrangements, concluded that United was free to conduct its trade in the manner which it deemed best for its own interests so long as it was not illegal. The judgement in this case, however, did not end on this note. Rather, the Judicial Committee of the Privy Council stated: "If the monopoly established by the appellants and their mode of carrying on their business be as oppressive as is alleged..., then the evil, if it exists, may be capable of cure by legislation..."[15]

The suggestion by the Judicial Committee to remedy the situation examined in the *United Shoe Machinery* case by legislation was taken up by Parliament with the enactment of the *Combines Investigation Act* in 1910. The primary purpose of the Act was to create investigative procedures to facilitate the application of competition law. The Act included, however, certain measures for dealing with "combinations of persons holding patents... who exercise their exclusive rights and privileges to restrict competition."[16] In particular, section 22 of the Act provided for the possible revocation of exclusive rights and privileges conferred under the *Patent Act* in cases where they had specific anti-competitive effects.

The test incorporated in the original IPR remedy provision in 1910 was similar to the one in the conspiracy provision of the Act. In particular, it referred to situations in which patents were used so as "unduly to prevent or limit competition," "unreasonably to enhance the prices [of articles]," etc.[17] It may be noted, however, that the test could also be satisfied where patents were used "to restrain or injure trade or commerce" in relation to an article (i.e., without reference to the criterion of undueness). In terms of process, in order for a patent to be revoked under this section, it was necessary for the

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[13] *U.S.* v. *United Shoe Machinery Co. of N.J.*, *ibid.*

[14] (1909) A.C. 330.

[15] (1909) A.C. 330 at p. 344.

[16] (1910) *Debates of the House of Commons*, cols. 2060, 6854, 9918 and 8000-01. United Shoe Machinery was cited as an example of this type of combination and the "monopolistic possibilities" that patents can confer.

[17] 9-10 Edward VII (1910) c. 9, s. 22.

Minister of Justice, subsequent to a report of a Board of Investigation established under the Act, to exhibit an information in the Exchequer Court indicating that an abuse had occurred and requesting revocation of the patent.

The significance of the patent abuse provisions in the *Combines Investigation Act* of 1910 should not be underestimated. These provisions constituted an important limitation on the broad scope given to patentees in early infringement cases for attaching restrictions to the sale or lease of patent-embodying products. These early cases indicated that the violation of tie-in, price and other restrictive conditions attached to the sale of a patented product constituted patent infringement on the basis that the buyer of the patented product obtained limited rights relating to its use. They further suggested that restrictions on the price or use of patented products could run with the products if they were notified to successive purchasers.[18]

The constitutional basis for the early patent remedy provisions (along with other aspects of Canadian combines legislation) was examined in the 1931 decision of the Judicial Committee of the Privy Council in the case of *Proprietary Articles Trade Association* v. *A.-G. Canada*.[19] The Judicial Committee concluded that the provisions were *intra vires* the federal Parliament as "reasonably ancillary" to its exclusive legislative authority under head 22 of section 91 of the *British North America Act* (subsequently the *Constitution Act, 1867*) respecting the grant of patents of invention and discovery. Specifically, the Committee stated: "It is an elementary point of self-preservation that the Legislature which creates the protection should arm the executive with powers of withdrawing or relaxing the protection if abused."[20] It should be noted, however, that this decision dealt only with the authority of the federal government to revoke or reduce patent protection which, at the time, was the only remedy available under the pertinent provisions of the *Combines Investigation Act*. The decision, therefore, does not explicitly support the other remedies for patent abuse, discussed below, that were subsequently added to the Act.

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[18] For example, see the cases of *Hatton* v. *Copeland - Chatterson* (1906) S.C.R. 651 and *National Phonograph Co.* v. *Menck* (1911), 28 R.P.C. 229. For discussion, see Harold G. Fox, *Canadian Patent Law and Practice* (4th. ed.) (Toronto: The Carswell Company Ltd., 1969), pp. 289-99 and 385-6, and Donald H. MacOdrum, *Canadian Law Relating to Technology and Competition* (mimeo, 1990), Part IV.

[19] (1931), 2 D.L.R. 1. The challenge mounted in this case was aimed at other provisions of the Act but the Judicial Committee also considered the constitutionality of the patent remedy provisions. These provisions had been left basically untouched by an earlier constitutional challenge, *Re: Board of Commerce Act, 1919 & Combines and Fair Prices Act* (1922), 1 A.C. 191, that led to major revisions in other aspects of Canadian competition legislation in 1923.

[20] *Proprietary Articles Trade Association* v. *A.-G. Canada*, *ibid.*, p. 11.

2.2 The Enactment of the Monopoly Exemption for IPRs and the Repeal of the Patent Remedy Provisions

Concern among Canadian legislators regarding possible anti-competitive abuse of IPRs surfaced again with the *Report of the Royal Commission on Price Spreads* and concurrent allegations of abuse of IPRs in the markets for radios, electrical goods and other products.[21] This led to the inclusion, in proposed amendments to the *Combines Investigation Act* put forward in 1935 and 1937, of recommendations for strengthening the application of the Act to perceived abuses of IPRs. These recommendations would have replaced the competition and restraint of trade tests in the patent remedy provisions with a broad public interest requirement and, arguably, created the possibility that the mere existence of IPRs would be subject to the monopolization provisions of the Act.[22]

The proposed legislation, however, met with stiff opposition in both the House of Commons and the Senate, where it was perceived as a threat to the incentive to innovate that the patent system was intended to create. In addition, it was argued that the need for stricter treatment of IPRs under the *Combines Investigation Act* had been eliminated by amendments to the *Patent Act* in 1935 dealing with failure to work patents in Canada or meet Canadian demand for patented articles on reasonable terms. The expanded *Patent Act* abuse provisions were asserted to be broad enough to deal with any anti-competitive abuses of patents.[23]

The potential conflict between the proposed amendments to the *Combines Investigation Act* and the integrity of the intellectual property system was resolved by providing explicit recognition of exclusive rights and privileges pertaining to intellectual property under the monopoly and combines provisions of the Act. For this purpose, a proviso was added to section 2 of the Act stating that its provisions on combines and monopolies "shall not be construed or applied so as to limit or impair any right or interest derived under the *Patent Act*, 1935 or under any other statute of Canada."[24] The addition of this proviso ensured that IPR owners could not be found guilty of illegal monopolization or combination merely by exercising their exclusive rights. Rather, it was necessary for them to go beyond the rights and interests conferred by the *Patent Act* or other intellectual property statutes in order to be found guilty of an offence. As discussed below, this principle has remained part of the legislation and was carried over with minor modifications in the abuse of dominance provisions of the *Competition Act* in 1986.

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[21] For discussion, see (1937) *Debates of the House of Commons*, pp. 2,420-21 and 2,555-57.

[22] See 25-26 George V (1935), c.54, s. 1, and 1 George VI (1937), c.23, s. 13. For discussion of these provisions, see the (1935) *Debates of the House of Commons*, pp. 3,857 and 4,279 and the (1937) *Debates of the House of Commons*, pp. 1,349-50 and 2407-11.

[23] See the (1937) *Debates of the House of Commons*, pp. 2,410-21 discussing the 1935 *Patent Act* amendments, 25-26 George V (1935), c. 150, ss. 65-66. and (1935) *Debates of the House of Commons*, pp. 3,097-3,272, especially p. 3,271.

[24] 25-26 George V (1935), c. 54, s.1. This proviso was initially implemented in the 1935 amendments to the Act. Its repeal was unsuccessfully proposed in 1937 by the MacKenzie King government which had won an election in the intervening period.

An additional, paradoxical aspect of the 1937 amendments to the *Combines Investigation Act* was the repeal of the patent remedy provisions, despite the initial proposal to expand them. The repeal of these provisions did not, however, reflect a declining concern regarding the potential for anti-competitive abuse of patents. Rather, it was based on a perception, after reflection on "the efficacy of existing remedies under the *Patent Act*," that the IPR remedies in the *Combines Investigation Act* had indeed become redundant.[25] As discussed below, this decision was subsequently revisited (and reversed) in light of the findings of Commissioner McGregor's report on *Canada and International Cartels* in 1945.

2.3 Early Developments Regarding the Use of Anti-competitive Abuses as a Defence in IPR Infringement Suits

In the period 1937 to 1943, there were several important decisions by the Supreme Court of Canada respecting the use of alleged anti-competitive abuses as a defence in intellectual property infringement suits. The first of these, *Massie & Renwick Ltd.* v. *Underwriters' Survey Bureau Ltd.* (1937), involved an application for an injunction brought by the Underwriters' Survey Bureau alleging unauthorized copying by the defendants of insurance schedules developed by the Bureau for the Canadian Fire Insurance Underwriters' Association.[26] The defendants argued, in response, that Underwriters' should not be entitled to enforce their copyrights on these materials on the grounds that their use in the infringement action and other proceedings was in the furtherance of a conspiracy and combination in violation of the *Combines Investigation Act*. Underwriters' initiated a motion to have this claim of defence struck.

In its decision on this motion, the Supreme Court, reversing an earlier decision of the Exchequer Court, concluded that in cases of this nature, the courts had sufficient discretion to consider such a defence based on principles of equity. In particular, if the relief sought constituted a step towards implementing an illegal conspiracy, it could be appropriate to decline relief. The Court stipulated, however, that in order for relief to be refused, the alleged conspiracy would have to be one which was injurious to the defendant.[27]

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[25] (1937) *Debates of the House of Commons*, p. 2,555.

[26] See, respectively, (1937) S.C.R. 265; (1939) S.C.R. 218 and (1940) S.C.R. 501; (1943) S.C.R. 396.

Two years later, the issue of the scope for use of alleged anti-competitive abuses as a defence in infringement cases was revisited by the Supreme Court in a second appeal based on further proceedings in the *Massie & Renwick* case. In its second decision, the Supreme Court advanced an alternative, seemingly narrower basis for such a defence. In particular, the Court suggested that a violation of the *Combines Investigation Act* could serve as a defence for infringement where the rights owner must rely upon an illegal agreement or conspiracy in order to establish ownership of the relevant IPRs.[28] Further consideration of this defence was not forthcoming, however, since the defendants in this case had failed to establish that an anti-competitive abuse had occurred.

The scope for use of an illegal conspiracy involving the plaintiff as the basis for a defence for infringement arose again in two separate decisions by the Supreme Court in *Philco Products Ltd. et al.* v. *Thermionics Ltd. et al.* The case involved an alleged infringement of vacuum tube patents. The appellants in this case had also initiated a motion to strike a defence based upon alleged violations of the *Combines Investigation Act*. In its first decision in the case, the Supreme Court again recognized the potential availability of a defence where a plaintiff's title rests on an illegal conspiracy. It ruled, however, that the factual basis for such a defence had not been established (or even properly pleaded) by the defendants.[29]

In light of the Supreme Court's decision, in subsequent proceedings in the case, the defendants led evidence to establish that the relevant patents had been obtained in connection with a conspiracy among the plaintiffs, in violation of the *Combines Investigation Act*. The alleged conspiracy involved the assignment of the relevant patents as well as other IPRs to Thermionics, a patent pool, by a number of competing manufacturers. Thermionics then licensed the IPRs back to the assignors and undertook other actions allegedly for the purpose of price-fixing. Each of the parties assigning rights to Thermionics was a party to the infringement action by virtue of their ongoing relationship with the company.

On re-appeal of the case to the Supreme Court, however, the Court held that the alleged conspiracy, even if it had been proven, would not have been a defence in the circumstances of the case. Rather, the Court found that the rights owners were entitled to enforce their rights because they had a valid claim to them prior to the beginning of the alleged conspiracy.[30]

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[27] (1937) S.C.R. 265, at p. 268.

[28] (1939) S.C.R. 218, at p. 244.

[29] (1940) S.C.R. 501, at pp. 504-05.

Thus, in these early cases the Supreme Court appeared to rule out broad use of anti-competitive abuses of IPRs as a defence in infringement cases. Rather, the decisions indicated that a defence would be available only in certain narrowly defined circumstances, such as where a plaintiff's cause of action relates directly to an alleged conspiracy. This was in contrast to the situation in the United States, where the relevant judicial decisions have provided broad scope for use of alleged antitrust violations as a defence in IPR infringement actions. The U.S. cases indicate that any use of IPRs in connection with an illegal conspiracy or arrangement can provide a defence, whether or not the abuse is related to the infringement action.[31]

2.4 The Reinstatement and Expansion of the Patent Remedy Provisions

Anti-competitive abuse of IPRs re-emerged as an important issue for Canadian legislators shortly after World War II with the release of the report of the Commissioner, *Combines Investigation Act*, on *Canada and International Cartels* (the *McGregor Report*). Chapter III of the Report, dealing specifically with the relation of patents to cartels and combines, suggested that "it might be... desirable to provide more specific statutory limitations, in conformity with the principles of Canadian law applying to undue restraints of trade, upon the power of patentees to impose restrictive provisions on licensees..."[32] Contrary to the thinking underlying the repeal of the patent remedy provisions in 1937, this report found that the *Patent Act* inadequately protected consumers' interests with respect to anti-competitive abuses of patents. In particular, the method by which investigations were initiated under the *Patent Act* abuse provisions, which relied primarily on the initiative and interests of persons seeking a compulsory licence, was found to be too narrow to protect the broader public interest.

The findings and recommendations of the *McGregor Report* were reflected in amendments to the *Combines Investigation Act* passed in 1946. These amendments included, as a major substantive element, the reinstatement of the IPR remedy provisions under the Act. The provisions passed in 1946, however, (from which the current IPR remedy provisions are derived) incorporated a number of changes designed to expand and facilitate their application to abuses. In particular, the range of IPRs covered by the provisions was broadened to include trademarks as well as patents, on the basis that trademarks may also "be used... to enforce arrangements as to the division of markets."[33]

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[30] (1943) S.C.R. 396, at pp. 406-07.

[31] See Robert J. Hoerner, "Patent Misuse," *Antitrust Law Journal*, vol. 53, Issue No. 3, October, 1984, pp. 641-62 and MacOdrum, *supra*, note 18.

[32] Commissioner, *Combines Investigation Act*, *Canada and International Cartels* (Ottawa: King's Printer, 1945).

In addition, the 1946 provisions put at the disposal of the Exchequer Court an expanded range of remedies to enable it to deal with anti-competitive abuses that would be difficult to correct under the *Patent Act*.[34] These remedies included the options of: (i) declaring void or restraining persons from carrying out offending terms or provisions in licences or other related agreements; (ii) ordering the grant of licences on appropriate terms; and (iii) directing that other actions be undertaken for the purpose of remedying an abuse.

Two other changes incorporated in the patent and trademark remedy provisions in 1946 should be noted. First, a test of undueness was added by the Senate to the subsection dealing with the use of patents or trademarks "to restrain or injure trade or commerce in relation to any... article or commodity." This amendment was made to avoid the possible threat, alluded to earlier, of patent or trademark remedies being applied to the mere exercise of IPRs. Thus, it was decided to continue the policy adopted in the 1935 and 1937 amendments to the *Combines Investigation Act* of protecting the basic exercise of IPRs from application of the Act. Second, a new proviso was added to the IPR remedy provisions to ensure that they would not be applied in a manner contrary to Canada's obligations under any international treaty, convention or other arrangement dealing with intellectual property.[35] This proviso affirmed Canada's commitment to honour international agreements on IPRs to which the country was a signatory as taking precedence over the possible application of competition policy to anti-competitive abuses.

Shortly after the reinstatement of the patent remedy provisions, allegations of anti-competitive abuse of IPRs were examined in a 1948 report by the Combines Investigation Commission on alleged violations of the *Combines Investigation Act* relating to optical goods. The arrangements examined in this investigation included licences that packaged eleven patents and three trademarks owned by four different U.S. based companies.[36] The licences, which by 1946 covered 90% of all optical frames and mountings sold in Canada, included provisions establishing prices to be charged at different levels of the market and restricting the sources from which manufacturers and distributors could obtain supplies. The Combines Investigation Commission concluded that the licensing scheme constituted an illegal conspiracy to lessen price competition to the detriment of the public. No further action was taken in this case under the *Combines Investigation Act*, however, due to certain evidentiary considerations, the abandonment of the arrangements forming the basis of the case and the initiation of separate actions by the Attorney General to have the relevant patents and trademarks set aside.[37]

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[33] (1946) *Debates of the House of Commons*, p. 3051.

[34] *Ibid.*, pp. 3051-52.

[35] (1946) S.C., c. 10, s. 9.

[36] Combines Investigation Commission, *Optical Goods: Investigation into an Alleged Combine in the Manufacture and Sale of Optical Goods in Canada* (Ottawa: Kings's Printer, 1948).

In sum, the years from 1910 to 1950 were an important period for the development of the competition policy-IPR interface in Canada. During this period, Canadian legislators dealt with the fundamental issue of whether competition policy should establish upper bounds on the exercise of market power arising from IPRs. A clear policy was established to protect basic exclusive rights and privileges pertaining to intellectual property under the *Combines Investigation Act* by exempting them from the monopoly provisions of the Act. Similarly, the courts adopted a stance that was supportive of the intellectual property system by limiting the scope for pleading anti-competitive abuses of IPRs as a defence in infringement cases. At the same time, the reinstatement of the IPR remedy provisions in the Act in 1946 reflected acceptance of the continuing need for effective application of competition policy to anti-competitive abuses of IPRs.

3.0 EFFORTS TO CONSTRAIN THE EXERCISE OF IPRS (1950-1980)

The period between 1950 and 1980 was one of widespread concern regarding the anti-competitive impact of IPRs and scepticism regarding their economic benefits. Reflecting these perceptions, the use of IPRs was an important focus of enforcement activity for Canadian competition officials during this period. Concerns about the impact of IPRs also led to a number of proposals for strengthening relevant provisions of the *Combines Investigation Act*. Competition law enforcement activities relating to IPRs during this period are discussed in subsection 3.1 of this section. The legislative proposals of this period are considered in subsections 3.2 and 3.3. Finally, subsection 3.4 considers some further developments in the 1970s regarding the use of anti-competitive abuses as a defence in IPR infringement cases.

3.1 IPR-Related Enforcement Activities, 1950-80

Concerns regarding the impact of patents on competition in the pharmaceutical industry were the basis for the *Report Concerning the Manufacture, Distribution and Sale of Drugs in Canada* released by the

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[37] See the references to this case in the *Annual Report* of the Commissioner, *Combines Investigation Act* for the years 1948-52.

Restrictive Trade Practices Commission (RTPC) in 1963.[38] The RTPC report was in response to a report on competitive conditions in the drug industry submitted by the then Director of Investigation and Research, Mr. D.H.W. Henry, to the Commission in 1961. These reports both concluded that the role of patents in the drug industry had led to restriction of competition and artificially high drug prices with negligible compensating advantages in terms of research activities in Canada. The RTPC's concern regarding excessive drug prices was subsequently reiterated by the Royal Commission on Health Services (the Hall Commission) in its report released in 1964. These findings also paralleled the conclusions of a major investigation of the drug industry in the U.S. by the Senate Sub-committee on Antitrust and Monopoly.[39]

The findings of the RTPC inquiry into the pharmaceutical industry and the Hall Commission led to the enactment, in 1969, of legislation that substantially strengthened the existing compulsory licensing provisions of the *Patent Act* applicable to drug patents. While compulsory licences for the manufacture of drugs in Canada had been available under these provisions since 1923, the 1969 legislation expanded these provisions to permit the importation of drugs (and their active ingredients) under such licences. Allowing importation of active ingredients was considered to be the key to enhanced competition from generic drug manufacturers, since these ingredients were not generally available from Canadian suppliers. In addition, subsequent to the 1969 amendments, a majority of the provincial governments enacted parallel legislation to encourage the use of generic drug products by pharmacists.[40]

Concerns regarding perceived anti-competitive abuse of IPRs were also reflected in an investigation into the distribution of pesticides in Canada by the RTPC in 1965.[41] In this case, the RTPC concluded that a chemical supplier had abused the exclusive rights derived under its patents and trademarks relating to a plant growth regulant by refusing to sell the regulant to one of its former distributors. While recognizing that a "legitimate monopoly arises out of patent rights," the Commission asserted that a patentee having a sole supplier position in a market could not use this monopoly to limit distribution for the purpose of controlling competition in that market, or to force a customer to buy other products.[42] The Commission's decision was significant since it implied that patent rights convey only limited authority to control the distribution of products by others in cases where they give their owners substantial market power, and do not protect the use of a patent-based monopoly to compel the purchase of unpatented products. However, no further legal action was taken in this case. Rather, because of a collapse of the potential market for the relevant product, it was felt that the abuse had no appreciable affect on the public interest.

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[38] Restrictive Trade Practices Commission, *Report Concerning the Manufacture, Distribution and Sale of Drugs* (Ottawa: Queen's Printer and Controller of Stationery, 1963).

[39] U.S. Congress, Senate, Committee on the Judiciary, Subcommittee on Antitrust and Monopoly (Estes Kefauver, Chairman), *Administered Prices: Drugs* (Senate Report 449, 87th Cong., 1st. sess., 1961).

[40] See Paul K. Gorecki, *Regulating the Price of Prescription Drugs in Canada: Compulsory Licensing, Product Selection and Government Re-imbursement Programmes* (Ottawa: Economic Council of Canada, Technical Report No. 88, 1981).

[41] See Restrictive Trade Practices Commission, *Distribution and Pricing of Pesticides* (Ottawa: Queen's Printer and Controller of Stationary, 1966).

In the late 1960s, concern regarding the anti-competitive abuse of patents led to the initiation of two cases under the IPR remedy provisions of the *Combines Investigation Act*. The cases centered on restrictive provisions employed by Union Carbide of Canada in licences to use the company's patented processes and machines for the extraction of polyethylene film from resin and treatment of this film for printing. The first of the two cases, initiated in October 1967, involved a number of provisions in Union Carbide's licences that prevented the use of relatively inexpensive imported polyethylene resin with the patented processes and machinery. The Crown alleged that these provisions unduly lessened competition in the production and supply of the resin in Canada. Other restrictive clauses in Union Carbide's licences were also alleged to be abusive on the basis that they limited the potential growth of individual licensees.[43]

The second *Union Carbide* case, initiated in 1969, involved licences for treating polyethylene film for printing. A number of provisions in these licences were alleged to constitute anti-competitive abuses. In particular, the Crown asserted that the use of sliding scale royalties had suppressed competition by discriminating against smaller producers. Also, grant-back provisions relating to patents taken out by licensees in regard to polyethylene film products were alleged to restrain trade in regard to polyethylene products not covered by the originally licensed patents. Other provisions alleged to be abusive included clauses: (i) preventing licensees from challenging the validity of the licensed patents even after the termination of their licensing agreements; (ii) establishing a constant royalty rate until the expiry of the last licensed patent; and (iii) restricting the type of film that licensees were allowed to treat using the patented process.[44]

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[42] *Ibid.*, pp. 6-13.

[43] Director of Investigation and Research, *Annual Report for the Year Ended March 31, 1968*, p. 42. See also Alec R. Szibbo, "The Canadian Antitrust Interface with Technology Agreements," in *Technology Agreements* (Vancouver, B.C.: The Continuing Legal Education Society of British Columbia, 1985), p. 4.2.06.

[44] Director of Investigation and Research, *Annual Report for the Year Ended March 31, 1972*, pp. 29-30, and Szibbo, *ibid.*

The Union Carbide cases were both resolved by settlements that addressed the main competition policy concerns. In the first case, Union Carbide agreed to extend royalty-free licences to any Canadian manufacturer engaged in the manufacturing of polyethylene film from resin, and eliminate the differences between royalty rates on domestically manufactured as opposed to imported resin. In the second case, the company agreed to revise the relevant licences to eliminate the sliding scale royalties, field-of-use restrictions, no-challenge clauses and provisions requiring the payment of royalties on patents after their expiry.[45]

The prevailing attitude of competition authorities towards IPRs during this period was evidenced in a speech before the Law Society of Upper Canada in 1974, by the then Senior Deputy Director of Investigation and Research, Roy Davidson.[46] To some extent, Davidson's speech paralleled the concurrent efforts by the U.S. Department of Justice to establish strict treatment of licensing practices.[47] Without condemning them outright, he outlined a number of licensing practices considered to "arguably" have the effect of extending or entrenching the patent monopoly grant. These included clauses: (i) requiring the payment of royalties after the expiry of the licensed IPRs; (ii) tying the use of IPRs to the purchase of products specified by IPR owners; (iii) restricting licensees' access to different channels of distribution; (iv) limiting exports; (v) resulting in higher royalty payments in Canada as compared to other countries; (vi) preventing validity challenges; (vii) tying out access to technologies or products other than those designated by the licensor; (viii) requiring the transfer of any inventions or improvements to the licensor; and (ix) restricting price, territories, quantity or fields-of-use for the purpose of sharing markets.

Restrictive patent licensing practices were the subject of another case, *R.* v. *Canadian General Electric and Union Carbide Canada Limited*, initiated under the *Combines Investigation Act* in 1978.[48] In this case, the Crown alleged that a provision in a patent licence provided by Canadian General Electric to Union Carbide, preventing the latter from selling patented insulation to users that did not own certain equipment, constituted an act of shared monopolization in violation of the Act. The manufacturing equipment that users were required to own in order to obtain the patented product was not necessary on technological grounds to produce or use the product. The alleged violation, however, was dismissed on an interlocutory motion on the basis that the Crown failed to establish the high burden of proof of detriment to the public that was required under the existing criminal monopoly provisions of the Act.

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[45] *R.* v. *Union Carbide Canada Limited*, Minutes of Settlement in the Exchequer Court of Canada, Dec. 9, 1969 and June 19, 1971, respectively. See the *Annual Report* of the Director of Investigation and Research for the years ended March 31, 1970 and 1972.

[46] Roy Davidson [former Senior Deputy Director of Investigation and Research], *Combines Considerations and the Licensing of Patents* (Notes for a Talk before the Law Society of Upper Canada, June 14, 1974). The approach to IPRs reflected in Davidson's address was noticeably stricter than that expressed in D.H.W. Henry, Q.C. (former Director of Investigation and Research), "Patents in Relation to the *Combines Investigation Act*," *Patent and Trademark Institute of Canada: Bulletin*, series no. 7, vol. 17, July 1966.

[47] See Bruce Wilson, *supra*, note 4.

[48] Unreported decision of Judge Charles, (Provincial Court, Judicial District of York, March 9, 1979). For discussion of this case, see Szibbo, *supra*, note 43, p. 4.2.10.

Finally, alleged anti-competitive abuses of IPRs were also examined in several discontinued inquiries during the 1960s and 70s referred to in the Annual Reports of the Director of Investigation and Research during this period.[49] These investigations dealt with the use of a number of licensing and marketing practices, including international price discrimination, exclusive licensing, tie-ins, refusal to supply and a joint sales and production venture, in regard to patents, trademarks and industrial designs. The investigations were discontinued, however, prior to the commencement of legal proceedings primarily due to a lack of sufficient evidence to establish that the relevant IPRs had been used either to restrain competition within the meaning of the IPR remedy provisions of the *Combines Investigation Act* or in connection with the operation of a monopoly to the detriment or against the interest of the public.

3.2 The Treatment of IPRs in the Stage I Amendments to the Combines Investigation Act

In the early 1970s, the federal government embarked on an ambitious program for reform of the *Combines Investigation Act*.[50] This program was based, in part, on proposals put forward in the 1969 *Interim Report on Competition Policy* by the Economic Council of Canada.[51] Reflecting the concerns raised in the above-noted cases and a number of studies, the strengthening of competition policy restraints on the exercise of IPRs was an important element of this program.[52]

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[49] See, for example, the *Annual Reports* of the Director of Investigation and Research, *Combines Investigation Act*, for the years 1964, pp. 31-33, 1967, pp. 47-51, 1971, pp. 55-56, 1972, p.34, 1973, pp. 49-50 and 1975, p. 27.

[50] For an overview, see Bureau of Competition Policy, *Competition Policy in Canada: The First Hundred Years* (Hull, Quebec: Consumer and Corporate Affairs Canada, 1989), pp. 25-30.

[51] Economic Council of Canada, *Interim Report on Competition Policy* (Ottawa: Queen's Printer, 1969).

[52] These studies included, in particular, the Royal Commission on Patents, Copyright and Industrial Designs (the Ilsley Commission), *Report on Patents of Invention* (Ottawa: The Queen's Printer and Controller of Stationery, 1960), Economic Council of Canada, *Report on Intellectual and Industrial Property* (Ottawa: Information Canada, 1971) and Consumer and Corporate Affairs Canada, *Working Paper on Patent Law Revision*, *supra*, note 3.

Bill C-256, introduced in Parliament in 1971, contained two major proposals that would have substantially altered the competition policy treatment of IPRs in Canada. First, the legislation would not only have removed the basic exemption for IPRs from the monopoly provisions of the Act, but would also have specifically provided that the Act applies to monopolies resulting "in whole or in part from ownership of or any right to use any patent, trademark, copyright or industrial design." Second, Bill C-256 would have authorized the use of IPR related remedies to prevent any use of a patent, trademark, copyright or industrial design to facilitate a criminal violation of the *Combines Investigation Act* or an action prohibited under proposed civil provisions of the Act.[53]

The proposals in Bill C-256 encountered strong opposition from members of the business and legal communities which viewed them as an unwarranted encroachment on basic exclusive rights pertaining to IPRs and a threat to the objectives and incentives underlying the intellectual property system.[54] As a consequence, they were largely removed from the 1975 "Stage I" amendments to the *Combines Investigation Act* which included only less controversial amendments for the purpose of facilitating their speedy passage.[55]

The Stage I amendments, nevertheless, incorporated a number of revisions bearing importantly on the competition policy treatment of IPRs in Canada. The amendments added a provision to the *Combines Investigation Act* clarifying that IPRs do not convey the right to maintain prices. This provision stipulated that the general prohibition of price maintenance under section 38 of the Act (now section 61 of the *Competition Act*) applies specifically to persons enjoying the exclusive rights and privileges of IPRs.[56]

Other provisions in the Stage I amendments, while not dealing specifically with intellectual property, had important implications for the treatment of related rights and interests under the *Combines Investigation Act*. The inclusion in the Act of provisions dealing with exclusive dealing, tied selling and market restriction (currently section 77 of the *Competition Act*) made available important new non-criminal measures for dealing with these practices in connection with IPRs. The tests incorporated in these provisions embody a case-by-case approach which is appropriate to the treatment of vertical market restraints.[57] The Stage I amendments also provided a new remedy for cases involving refusals to deal which may be relevant to some situations involving IPRs.[58]

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[53] See *Bill C-256*, 3rd. sess., 28th. Parl., 1970-71, particularly sections 17, 41 and 51.

[54] See, e.g., Patent and Trademark Institute of Canada, *Brief to the Minister of Consumer and Corporate Affairs in Respect of Bill C-256* (The *Competition Act*) (mimeo, November, 1971).

[55] Other elements of Bill C-256 were also withdrawn in response to heavy criticism from the business community. See, generally, W.T. Stanbury, *Business Interests and the Reform of Canadian Competition Policy, 1971-75* (Toronto: Carswell/Methuen, 1977).

[56] See R.D. Anderson and S.D. Khosla, "Recent Developments in the Competition Policy Treatment of Resale Price Maintenance," *Canadian Competition Policy Record*, vol. 6, no. 4, pp. 1-14.

It should be noted that the Stage I amendments also provided certain exceptions from the civil reviewable practices provisions that are applicable in situations involving IPRs. Paragraph (5)(d) of section 77 excludes from the application of the section certain arrangements involving the grant of rights to use a trademark or trade name, where: (i) the grantee follows a marketing plan or system prescribed by the grantor for a "multiplicity" of products from competing suppliers; and (ii) no single product dominates the business. This exception covers multi-product franchise outlets, such as Canadian Tire. Subsection (6) excludes from othe application of the section market restriction arrangements whereby a trademark owner supplies ingredients that are processed by another party into food or drink sold in association with the trademark. This exception applies to food and drink franchise outlets such as McDonald's.[59]

Finally, another provision added in the Stage I amendments that relates importantly to the competition policy treatment of IPRs was section 31.1 (now section 36 of the *Competition Act*). This section provides a civil cause of action for persons who have suffered loss or damage as a result of a violation of the criminal provisions of the Act or a failure to comply with certain remedial orders.[60] As discussed below in subsection (4), the enactment of this provision led to further developments relating to the scope for use of competition offences as a defence in IPR infringement suits.

3.3 The Treatment of IPRs in the Early Stage II Proposals for Amendments to the Combines Investigation Act

Measures to substantially strengthen the application of Canadian competition law to IPRs resurfaced again in the early Stage II proposals for amendments to the *Combines Investigation Act*. Bill C-13, introduced in

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[57] The new Canadian provisions anticipated subsequent refinements in corresponding U.S. judicial doctrines. See R.D. Anderson and S.D. Khosla, "Recent Developments in the Competition Policy Treatment of Tied Selling in the U.S. and Canada," *Canadian Competition Policy Record*, vol. 6, no. 1, pp. 1-14.

[58] See the *Competition Act*, section 75.

[59] For elaboration, see Ian Nielsen-Jones, S. Dev Khosla and Robert D. Anderson, *Product Distribution and the Competition Act: The Treatment of Reviewable Matters and Price Maintenance* (Notes for an Address to the Distribution Law Seminar, B.C. Continuing Legal Education Society, S-10172, October 18, 1988).

[60] The violations to which this section refers include conspiracies in restraint of trade, price maintenance, price discrimination, bid-rigging and other actions outlined in Part V of the Act, as well as failure to comply with an order of prohibition made under the Act.

Parliament in November, 1977, proposed replacing the existing IPR remedy provisions of the Act with a new civil reviewable provision, section 31.74, to be administered by the Competition Board. Under this section the Board would have been empowered to apply IPR remedies in any case where, "on application by the Competition Policy Advocate," it found that any intellectual property right or interest had been exercised "in a manner not expressly authorized by the enactment conferring or authorizing the right or interest" with the result that competition in a market was adversely affected. The remedies available to the Competition Board were to include declaring unenforceable or preventing the carrying out of parts of relevant licences or other agreements, or directing the grant of compulsory licences in regard to abused patents, copyrights or industrial designs.[61]

Like the proposals in Bill C-256, section 31.74 of Bill C-13 met with resistance on the basis that it was overly restrictive of the exercise of IPRs. In particular, the exemption provided for expressly authorized use of intellectual property rights or interests was asserted to be too narrow particularly when compared to the exemption in the monopoly provisions of the Act. In addition, the threshold of anti-competitive effects required under section 31.74 was lower than that of other provisions of the proposed legislation which required a substantial or undue lessening of competition.[62] Section 31.74 died on the Order Paper along with the other provisions of Bill C-13.

3.4 Further Developments Concerning Anti-competitive Abuse of IPRs as a Defence in Infringement Cases

In 1973, the issue of whether an alleged violation of the *Combines Investigation Act* could serve as a defence in an intellectual property infringement suit was revisited in the Federal Court of Appeal decision in *RBM Equipment Ltd.* v. *Philips Electronics Industries*.[63] The case originated with an action brought by the owner of a registered industrial design alleging infringement of the design by a terminated licensee. In its defence, the former licensee asserted that its termination by the design owner was in furtherance of an illegal resale price maintenance scheme, in violation of section 38 of the

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[61] Bill C-13, 3rd. sess., 30th. Parl., 1977. These provisions first appeared as section 31.74 of Bill C-42, 2nd. sess., 30th. Parl., 1977 which proposed giving the Tribunal the added power to revoke or expunge patents and trademarks.

[62] See the Canadian Bar Association, *Submission with respect to Bill C-42 - An Act to amend the Combines Investigation Act* (Submission to the Standing Committee on Finance, Trade and Economic Affairs, May 20, 1977) and John C. Osborne "Industrial Property and Bill C-13," in J.W. Rowley and W.T. Stanbury (editors), *Competition Policy in Canada: Stage II, Bill C-13* (Montreal: Institute for Research on Public Policy, 1978), pp. 273-306.

[63] (1973), 9 C.P.R. (2d) 46 (Federal Court Trial Division); 10 C.P.R. (2d) 23 (Federal Court of Appeal).

Combines Investigation Act (now section 61 of the *Competition Act*). The design owner subsequently initiated a motion to have the defence struck.

The Court of Appeal, based upon a review of the *Massie & Renwick* and *Philco* cases, concluded that there could be grounds for a defence in this case. The Court stated:

> I do not think it follows... that a defence to an infringement action cannot be founded on illegality in the agreement or transaction by which the title asserted by the plaintiff has been acquired or in the purpose for which the agreement or transaction has been entered into or carried out. Rather...the possibility of a defence based on such illegality...remains open.[64]

This passage was interpreted by the Federal Court in further proceedings in this case to allow a possible defence to an infringement action where the relevant rights were obtained in connection with an illegal conspiracy and the infringement action is a step in the implementation of the conspiracy.[65] A similar interpretation of the Court of Appeal's holding in this case was given by the Federal Court (Trial Division) in the 1975 case of *Amoco Can. Petroleum Co. Ltd.* v. *Texaco Exploration Can. Ltd.* in which the Court upheld a motion to strike a statement of defence based on alleged anti-competitive abuse.[66]

The possibility of a defence based on anti-competitive abuse of allegedly infringed IPRs was raised again in the 1976 case of *Eli Lilly and Co.* v. *Marzone Chemicals Ltd.*, which took place shortly after the passage of the Stage I amendments to the *Combines Investigation Act*.[67] In this case, the Federal Court (Trial Division), in a decision later upheld by the Court of Appeal, refused to strike a statement of defence and part of a counterclaim in a patent infringement action based on an alleged anti-competitive agreement. In support of its decision, the Court invoked the recently enacted civil damage provision of the Act. In particular, the Court noted "the distinct possibility of section 31.1 now affording a defence at law which did not exist formerly."[68] The decision in this case, therefore, suggests the possibility of a broader defence based on illegal use of IPRs than was established in the earlier cases. The judgment in the *Eli Lilly* case also noted the possibility that a competition law violation could constitute grounds for denial of equitable relief, even where it did not provide a defence in law.[69] Such relief (e.g., an injunction barring further use of patented technology) can be a key aspect of infringement cases.[70]

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[64] (1973), 9 C.P.R. (2d) 46 (Federal Court Trial Division), pp. 58-59. In support of its holding, the Court gave the following interpretation of the early Supreme Court decision in the *Massie & Renwick* and *Philco* cases: "The first *Massie & Renwick* case indicates that where the action is brought or the relief is claimed in furtherance of an illegal scheme the Court will decline relief. The second *Massie & Renwick* case and the first *Philco* case, moreover, appear... to indicate the possibility that an infringement action may fail when the plaintiff's title rests upon a criminal act."

[65] (1973), 10 C.P.R. (2d) 23 (Federal Court of Appeal), p. 26.

[66] (1976), 1 F.C. 258.

[67] (1976), 29 C.P.R. (2d) 253, (Federal Court Trial Division); (1977), 2 F.C. 104, (Federal Court of Appeal).

In sum, the period from 1950 to 1980 was one of strong emphasis on application of Canadian competition law to perceived anti-competitive abuses of IPRs. The resulting investigations led, however, to surprisingly little jurisprudence on the competition-IPR interface. This situation can be attributed to a number of factors. First, in several of the cases outlined above, the lack of any jurisprudence was due to the cessation of the practices forming the basis for the proceedings and/or the expiry of the relevant IPRs.

Second, the criminal nature of the monopoly provisions of the *Combines Investigation Act*, which formed an important basis for the application of competition policy to alleged abuses of IPRs during this period, contributed to the lack of case law development. The criminal monopoly provisions embodied a high standard of proof of control over a market and detriment to the public interest in order for a violation to be found. These standards were excessive in view of the difficulty of determining with certainty the economic effects of the practices under examination.[71]

Finally, the IPR remedy provisions of the *Combines Investigation Act*, while not technically criminal, were viewed as embodying a similar threshold of anti-competitive effects.[72] The basis for this view is the resemblance between the wording used in this provision and the criminal conspiracy provision of the Act (currently section 45 of the *Competition Act*). The cases litigated under the latter provision indicate that the test of undueness embodies a high threshold of anti-competitive effects. In addition, there are indications that, as a special remedy, the IPR remedy provisions tended to be viewed as secondary to the enforcement of the main provisions of the *Combines Investigation Act* dealing with monopolization and conspiracy.[73]

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[68] (1976), 29 C.P.R. (2d) 253, at p. 255.

[69] *Id.*, at p. 255. See also *Zelon Industries Ltd. et al.* v. *Bonar & Benis Ltd. et al.*, 39 C.P.R. (2d) 5, (Federal Court Trial Division), in which an allegation of tied sales was put forward by the defendant as an argument against the granting of equitable relief.

[70] For further discussion of the relation of equitable principles to relief sought in infringement actions, see MacOdrum, *supra*, note 18, pp. 28-30.

[71] The difficulties entailed in enforcing the former criminal monopoly provisions are well documented in, among others, W.T. Stanbury, "Monopoly, Monopolization and Joint Monopolization," in J. Rowley and W.T. Stanbury (editors), *supra*, note 62, pp. 134-75, and C.J. Michael Flavell, *Canadian Competition Law: A Business Guide* (Toronto: McGraw-Hill Ryerson Limited, 1979), pp. 200-04.

[72] For example, see Flavell, *id.* pp. 317-19 and Szibbo, *supra*, note 43, pp. 4.2.04-06.

The legislative proposals of the 1970s respecting the competition policy-intellectual property interface would have established much stricter treatment of IPRs under Canadian competition law. These measures, however, were not approved by Parliament. Consequently, the most significant changes in Canadian competition legislation affecting the treatment of IPRs were probably the non-IPR specific changes such as the enactment of the new non-criminal provisions to deal with tied selling, exclusive dealing and market restriction as well as the civil damages provision.

4.0 THE 1980S: A DECADE OF LEGISLATIVE AND POLICY REFINEMENTS

As discussed in the Introduction to this paper, in the 1980s, there was growing acceptance of the role of intellectual property rights from the competition policy perspective in Canada and abroad.[74] Whereas in the past, such rights had been tolerated as "statutory monopolies," in the 1980s they were increasingly viewed as serving useful, pro-competitive functions in a market economy.[75] In Canada, the change in the competition policy perspective toward IPRs coincided with a general recognition that the country had more to gain than was previously realized from maintaining high standards of intellectual property protection.[76]

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[73] In this regard, D.H.W. Henry, Q.C. (former Director of Investigation and Research), stated in a 1966 address to the Patent and Trademark Institute of Canada, that an inquiry "directed towards the use of a patent" would ordinarily be expected "...to proceed on the basis that there is reason to believe that by misuse of the patent a breach of the combination or monopoly provisions of the *Combines Act* may be disclosed." See D.H.W. Henry, *supra*, note 46, p. 5.

[74] Regarding the current competition policy perspective toward IPRs in Canada, see Howard I. Wetston, Director of Investigation and Research, *Competition Policy and Intellectual Property Rights: Complementary Framework Policies for a Market Economy* (Notes for an Address to the Conference on Global Rivalry and Intellectual Property: Developing Canadian Strategies, Sponsored by the Institute for Research on Public Policy, Toronto, April 25, 1990). For an overview of developments in various OECD countries, see Organization for Economic Cooperation and Develpment, *Competition Policy and Intellectual Property Rights* (Paris: OECD, 1989), ch. IV.

[75] For an overview of U.S. developments, see R.D. Anderson, S.D. Khosla and M.F. Ronayne, *The Competition Policy Treatment of Intellectual Property Licensing in the U.S. and Canada* (Hull, Quebec: Bureau of Competition Policy, Economics and International Affairs Branch, mimeo, 1987).

[76] For pertinent discussion, see Consumer and Corporate Affairs Canada, *supra*, note 10. In 1982, a paper by M. Berkowitz and Y. Kotowitz suggested that the optimal level of intellectual property protection depends chiefly on structural characteristics other than a country's size such as the state of competition and ownership patterns in the innovative industries. See M. Berkowitz and Y. Kotowitz, "Patent Policy in an Open Economy," *Canadian Journal of*

The limited modifications during the 1980s in Canadian competition legislation applicable to intellectual property rights reflected these conceptual developments. The attempts to strictly constrain the exercise of patents, copyrights and trademarks that characterized the legislative proposals of the 1970s were dropped from Bills C-29 and C-91 which led to the new *Competition Act* of 1986. At the same time, both the 1986 amendments and the subsequent consequential amendments to the *Competition Act* in the 1988 revisions to the *Copyright Act* reflected continuing awareness of the need for competition law provisions to counteract any proven abuses of IPRs. A shift toward greater acceptance of the role of IPRs was also evident in the amendments to the compulsory drug patent licensing provisions of the *Patent Act* (Bill C-22) in 1986-87. The latter amendments did not involve competition legislation as such but impacted directly on previous policies adopted with the involvement of the Director of Investigation and Research. This part of the paper reviews these matters and some related constitutional and case developments illustrating the evolving competition policy treatment of intellectual property rights in Canada.

4.1 The Treatment of Intellectual Property Rights in the 1986 Competition Law Amendments

The 1986 amendments establishing the *Competition Act* contained no major new provisions relating to intellectual property rights.[77] There were, however, two developments which should be noted. First, the amendments included a general exception for the exercise of intellectual property rights in the new provisions of the Act dealing with abuse of a dominant position (ADP). These provisions (sections 78 and 79) replaced the old criminal monopoly provisions of the *Combines Investigation Act* (section 33 in conjunction with the definition of a monopoly in section 2). The exception for intellectual property rights from the AOD provisions parallels the above-noted exception contained in the old monopoly provision.[78]

Economics, 1982, pp. 1-19. There are, however, several limitations on the Berkowitz-Kotowitz analysis. For example, it discounts the potential for retaliation by technology exporting countries against technology importing countries that adopt opportunistic policies. See Murray G. Smith, "Global Rivalry and Intellectual Property: Implications for Canadian Economic Policies," in *Global Rivalry and Intellectual Property: Developing Canadian Strategies* (Institute for Research on Public Policy: Materials provided for a conference held in Toronto on April 25, 1990).

[77] For an overview of the 1986 amendments, see Bureau of Competition Policy, *supra*, note 50.

[78] The definition of a monopoly in Section 2 of the *Combines Investigation Act* stipulated as follows: "... a situation shall not be deemed a monopoly within the meaning of this definition by reason only of the exercise of any right or enjoyment of any interest derived under the *Patent Act*, or any other Act of the Parliament of Canada."

The ADP provisions are non-criminal sections of the Act that provide remedies for a broad range of potentially anti-competitive acts. A non-exhaustive illustrative list of such acts is provided in section 78 of the legislation. The list includes acts such as: (i) pre-emption of scarce facilities or resources required by a competitor for the operation of a business, with the object of withholding the facilities or resources from a market; (ii) adoption of product specifications that are incompatible with products produced by any other person and are designed to prevent his entry into, or to eliminate him from, a market; or (iii) requiring or inducing a supplier to sell primarily to certain customers, or to refrain from selling to a competitor, with the object of preventing a competitor's entry into, or expansion in, a market. There is good reason to believe that the new non-criminal AOD provisions will prove to be a much more appropriate means of dealing with anti-competitive business practices (including practices involving IPRs) than the previous criminal monopoly provisions.[79]

The wording of the exception for IPRs from the ADP provisions bears careful consideration. Section 79(5) states that:

> (5) For the purpose of this section, an act engaged in pursuant only to the exercise of any right or enjoyment of any interest derived under the Copyright Act, Industrial Design Act, Patent Act, Trade Marks Act or any other Act of Parliament pertaining to intellectual or industrial property is not an anti-competitive act.

Section 79(5) indicates clearly that the ADP provisions are not intended to affect the legitimate exercise of intellectual or industrial property rights. It covers not only express rights but also interests derived under the intellectual property statutes. Section 79(5) is arguably somewhat narrower than the exception for IPRs in the old monopoly provisions.[80] Moreover, it does not provide a blanket exemption for intellectual property rights holders from the application of the section. The use of the phrase "pursuant only to the exercise of any right..." suggests that section 79 remains applicable to the use of such rights in ways which go beyond the purposes contemplated in the statutes.[81]

Even in situations where section 79 applies to the use of intellectual property rights, the application of the section requires an in-depth evaluation of the competitive effects of specific acts. Subsection 79(1) requires proof of

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79. See Bruce C. McDonald, "Abuse of Dominant Position," *Canadian Competition Policy Record*, vol. 8, no. 1, March 1987, pp. 59-75 and R.D. Anderson and S.D. Khosla, "Reflections on McDonald on Abuse of Dominant Position," *Canadian Competition Policy Record*, vol. 8, no. 3, September 1987, pp. 51-60.

80. The previous exception in section 2 of the *Combines Act* was not explicitly limited to Acts of Parliament pertaining to intellectual or industrial property. See Anderson and Khosla, *id.*

81. *Id.*, at p. 55.

three specific elements: (i) that the firm(s) involved substantially or completely control a class or species of business; (ii) that the firm(s) have engaged in a practice (as distinct from an isolated instance) of anti-competitive acts; and (iii) that the practice of anti-competitive acts has had the effect of lessening competition substantially. In addition, subsection 79(4) of the Act requires the Competition Tribunal to consider whether a practice is the result of superior competitive performance.

A second aspect of the 1986 competition law amendments with specific implications for intellectual property rights was the enactment of section 86 of the *Competition Act* concerning specialization agreements. In conjunction with sections 85 and 91, this section provides for the non-application to specialization agreements that have been duly registered with the Competition Tribunal of section 45 of the *Competition Act* dealing with conspiracies in restraint of trade and section 77 of the Act as it relates to exclusive dealing. The purpose of these potentially very important (but to date unused) sections is to facilitate industrial rationalization and help Canadian firms to compete effectively in international markets.[82]

The reference to intellectual property is contained in subsection 86(4) of the provisions governing specialization agreements. As a condition for registration of an agreement, this subsection authorizes the Competition Tribunal to make orders requiring the wider licensing of patents. In effect, therefore, subsection 86(4) makes it possible for firms to avoid potential liability for certain actions relating to specialization agreements through undertakings to ensure wider licensing of patents and/or other competition enhancing measures.

In addition to the above-noted new provisions, the 1986 *Competition Act* carried over without modification two other key sections of the previous legislation referring to intellectual property rights: section 29 (now re-numbered as section 32) and section 38 (now section 61). As discussed in Part 3, section 32 provides remedies for certain anti-competitive abuses of IPRs. Section 61 is the price maintenance section of the Act. The 1986 Act also incorporated without substantive modification section 31.4 of the Act (now section 77) which provides for a case-by-case approach to tied selling, exclusive dealing and territorial market restriction.

4.2 The 1987 Revisions to the Compulsory Drug Patent Licensing Provisions of the Patent Act

The 1987 amendments to the drug patent licensing provisions of the *Patent Act* further illustrated a trend toward greater acceptance of the role of IPRs in Canada. As noted in part III above, provision for compulsory licensing for the manufacture of drugs has existed in the *Patent Act* since

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[82] Consumer and Corporate Affairs Canada, *Competition Law Amendments: A Guide* (Ottawa: Supply and Services Canada, 1985), p. 9.

1923. In 1969, the relevant provisions were broadened to provide authorization for importation of drugs under compulsory licence. The 1969 amendments were in response to a series of reports that trace back to a submission to the Restrictive Trade Practices Commission by a previous Director of Investigation and Research, in 1961.[83]

The 1969 amendments were generally acknowledged to have stimulated competition and reduced drug prices. In the early 1980s, however, there were increasing concerns over alleged adverse effects on employment and research and development in the industry. In 1984, the government appointed a Commission of Inquiry on the Pharmaceutical Industry (the Eastman Commission) to examine the impact of compulsory licensing, related aspects of government policy, and growth prospects in the pharmaceutical industry generally.

The then Director of Investigation and Research under the *Combines Investigation Act*, Lawson A.W. Hunter, made a submission to the Eastman Commission on August 14, 1984.[84] The submission supported retention of the compulsory licensing system and pointed out that the extension of the compulsory licensing provisions in 1969 did not have a demonstrable adverse impact on the levels of research and development, employment and growth in the industry. In his remarks before the Commission, however, the Director accepted the apparent need for adjustment in royalty rates to rectify a perceived competitive imbalance between patent-holding and generic drug firms.[85]

In May 1985, the government released the report of the Eastman Commission.[86] In general, the Report supported retention of the compulsory licensing system on grounds similar to those cited in the Director's submission. At the same time, the Report recommended a number of modifications to restore a competitive balance between patent-holding and generic drug firms. These recommendations included: (i) an increase in the royalties paid by generic companies under compulsory licences; and (ii) enactment of a minimum market exclusivity period before compulsory licences could be issued.

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[83] See part III of this paper and references cited therein.

[84] Lawson A.W. Hunter [then Director of Investigation and Research], *Submission to the Commission of Inquiry on the Pharmaceutical Industry* (August 14, 1984). See also "Altering Act will raise drug price: official," *Globe and Mail*, October 18, 1984.

[85] Hunter stated: "... the merits of compulsory licensing should be assessed separately from the issue of the appropriateness of the current 4% royalty rate. While strongly supporting the former, I do not necessarily endorse the latter, whose level in any case is not fixed by section 41(4). The royalties paid under compulsory licences are important as a means of providing due recognition to patent holders." Lawson A.W. Hunter, *Oral Statement Before the Commission of Inquiry on the Pharmaceutical Industry* (October 17, 1984).

[86] H.C. Eastman, Commissioner, *The Report of the Commission of Inquiry on the Pharmaceutical Industry* (Ottawa: Supply and Services Canada, 1985).

In 1987, Parliament enacted Bill C-22, the *Bill to amend the Patent Act*, following extended hearings in both the House of Commons and the Senate. The amendments followed the Eastman Commission recommendations to the extent that they modified rather than abolished the compulsory licensing system for the drug industry. However, Bill C-22 incorporated significantly longer exclusivity periods (generally 7-10 years) than were recommended by the Commission.[87] In addition, it established a Patented Medicines Prices Review Board to monitor prices, the speed with which new drugs are introduced and other aspects of performance in the drug industry. The Bill also contained a number of important provisions not limited to the drug industry to streamline and modernize the *Patent Act* generally.[88]

In terms of its implications for competition policy, Bill C-22 is significant for two reasons. First, the legislation clearly reflected a more favourable view of the role of patents and their implications for competition and performance in the drug industry than prevailed at the time of the 1969 amendments. Whereas the RTPC had viewed patents as undesirable statutory restraints on competition, Bill C-22 attached greater importance to their role in encouraging R&D and rapid introduction of new drugs in Canada. Second, notwithstanding the general impact of the amendments in diluting the compulsory licensing system, the development of Bill C-22 illustrated the continuing need for competition policy input to the design and review of IPR legislation. The input of the Director and other persons representing consumer interests was instrumental in ensuring a balanced assessment of the issues.

During the period in which the amendments to the *Patent Act* were being developed and considered by Parliament, the constitutional validity of the provision was tested in the courts. In *Smith Kline & French Laboratories Ltd. et al.* v. *Attorney General of Canada*, the plaintiff-appellant sought a declaration that the compulsory licensing provision was invalid as being a matter in relation to property and civil rights, and therefore within provincial jurisdiction under section 92(13) of the *Constitution Act, 1867*.[89] The appellant also argued that the compulsory licensing provision was in violation of several sections of the *Charter of Rights and Freedoms* as well as the *Canadian Bill of Rights*. In his judgment for the Federal Court (Trial Division), Mr. Justice Strayer rejected the application on all grounds. He found in particular that the compulsory licensing section fell within the federal authority over patents. On appeal, the Federal Court of Appeal upheld the trial court judgment respecting each of the plaintiff's claims.

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[87] As an incentive for R&D in Canada, Bill C-22 provided for longer periods of exclusivity for drugs invented in Canada as compared to drugs invented abroad. See the *Patent Act*, R.S.C. 1985, as amended, s. 39.16.

[88] The general amendments in Bill C-22 included measures to: (i) change from the basic rule for awarding patents "first to invent" to the rule "first to file"; (ii) extend the term of protection from the previous 17 years from the date the patent is granted to the international norm of 20 years from the date an application is filed; and (iii) ratify the multilateral *Patent Cooperation Treaty*.

[89] (1986), 7 C.P.R. (3d) 145; upheld (1987), 12 C.P.R. (3d) 385.

4.3 The 1988 Copyright Act Amendments

Another important development in the 1980s demonstrating an attempt to ensure balance and mutual support between intellectual property and competition legislation involved the 1988 amendments to the Canadian *Copyright Act*. These amendments were intended to foster the establishment of collective societies to administer rights in "new" fields of copyright such as photocopying, in which individual enforcement of rights was deemed to be unworkable.[90] Collective administration of rights has been the practice for many years in the field of musical performances, which are governed by separate provisions of the *Copyright Act*.[91] Extension of this approach was considered to be necessary in light of the expanded possibilities for unauthorized reproduction of copyrighted materials resulting from modern communications technology and the prohibitively high costs for individual rights holders of monitoring such activities.[92] During the development of the amendments, the Director of Investigation and Research made a submission to the House of Commons' Subcommittee on Revision of Copyright which recognized the potential efficiency benefits of this approach.[93]

To facilitate the operation of collectives, the *Copyright Act* amendments provide a limited exemption from section 45 of the *Competition Act* for certain collective licensing agreements to be entered into by copyright collectives operating in new fields (subsection 50.5(3) of the amendments). The exemption from section 45 is available only in respect of agreements regarding rates and related terms and conditions for the grant of a licence by a collective. Such exemption is conditional on the agreement being filed with the new Copyright Board by the collective or the user(s) within 15 days.

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[90] See Consumer and Corporate Affairs Canada, *From Gutenberg to Telidon: A White Paper on Copyright* (Ottawa: Supply and Services Canada, 1984), Section VIII.

[91] Provision for collective administration of performing rights in the *Copyright Act* grew out of the 1935 recommendations of the Royal Commission on the Canadian Performing Rights Society. See Royal Commission Appointed to Investigate the Activities of the Canadian Performing Rights Society, Limited, and Similar Societies [The Parker Commission], *Report* (Ottawa: King's Printer, 1935).

[92] Douglas A. Smith, *Collective Agencies for the Administration of Copyright* (Consumer and Corporate Affairs Canada, Copyright Revision Studies, 1983).

[93] Lawson A.W. Hunter [then Director of Investigation and Research], *Submission to the Subcommittee on Revision of Copyright* (April, 1985).

Agreements which are filed with the Board in this manner are subject to a special review process involving the Copyright Board and the Director of Investigation and Research. Under this regime, the Director is given access to all agreements filed with the Board (subsection 50.5(4)). Where the Director believes that the public interest may be harmed by an agreement, he is empowered to apply to the Board which may then alter the agreement and establish such other royalties and related terms and conditions as the circumstances require (subsection 50.5(5) and section 50.6). This function of the Director is especially important since the Board has no authority to initiate review proceedings on its own motion.

The Director is unlikely to apply for review of the majority of agreements filed with the Board. Under the terms of the Act, he may apply for a review only where he believes that an agreement will harm "the public interest". Presumably this wording is intended to accommodate the competition policy concerns that may be raised by the Director while providing an additional degree of flexibility for the Board.

An important balancing provision contained in the *Copyright Act* amendments was a related amendment to section 32 of the *Competition Act*. This amendment expanded the scope of the section to deal with situations in which arrangements pertaining to copyright have the effect of lessening competition unduly. As discussed in Parts 2 and 3, section 32 previously dealt only with abuse of patents, trademarks and industrial designs.

4.4 Related Constitutional and Case Developments

Towards the end of the 1980s, there was another constitutional development with implications for the competition policy-intellectual property interface in Canada. The Supreme Court of Canada decisions in the *City National Leasing* and *Rocois* cases resolved the uncertainty regarding the constitutionality of the private damages remedy in the *Competition Act*.[94] In its decisions, the Supreme Court upheld the validity of the private damages remedy (and the Act as a whole) under the general branch of the federal trade and commerce power. As discussed in Part 3, in the 1976 *Eli Lilly* case, the private damages remedy was cited as a possible ground for a defence based on anti-competitive abuses in IPR infringement cases. Accordingly, the Supreme Court decisions in *City National Leasing* and *Rocois* may lead to further jurisprudence respecting the competition policy-intellectual property interface in the context of patent infringement suits.[95]

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[94] *General Motors of Canada Ltd.* v. *City National Leasing et al.* (1989), 24 C.P.R. (3d) 417 and *Quebec Ready Mix Inc. et al.* v. *Rocois Construction Inc.* (Supreme Court of Canada, April 20, 1989). For commentary, see "Historic Supreme Court Decision Upholds Federal Competition Legislation," *Canadian Competition Policy Record*, vol. 10, no. 2, June 1989.

The first application by the Director of Investigation and Research to the Competition Tribunal under the new abuse of dominance provisions, the *NutraSweet* matter, raised a number of issues concerning the role of IPRs in the intense sweetener industry. A key allegation of the Director in this case was that the NutraSweet Company (NSC) had employed its well-known trademark to foreclose competition in the market for aspartame by paying a substantial allowance to customers who displayed its logo.[96] The company's continuing patent protection in the U.S. market and its implications for competition in the Canadian market also formed part of the background of the case.

In its decision in the case, the Competition Tribunal accepted the Director's argument that the logo display allowance constituted an anti-competitive act, particularly in view of the associated requirement for customers displaying the logo to use exclusively NutraSweet brand aspartame.[97] In the Tribunal's view, this created an "all or nothing" choice for purchasers, which impeded entry by new suppliers. (When both the logo display and related promotional allowances were combined, the effective price reduction was up to 40%.) The remedial order issued by the Tribunal specifically prohibits NutraSweet from continuing to offer discounts for the display of its trademark or logo and from engaging in other acts, such as offering its customers meet-or-release or "most-favoured nation" clauses, which were deemed to be anti-competitive.[98]

The Tribunal also accepted a submission by the Director that NutraSweet had used its continuing patent protection in the U.S. to exclude competition in Canada, through a rebate offered to a Canadian customer in connection with imports of aspartame made in the U.S. The Tribunal apparently viewed aspects of NutraSweet's marketing strategy as an attempt to artificially extend the duration of the company's Canadian patent protection. This came out in its commentary on NutraSweet's argument that its various exclusivity clauses were necessary to prevent free riding and to enable the company to recoup the costs it incurred in obtaining regulatory approvals and developing the market. In this regard, the decision states that "The Tribunal does not accept that NSC is entitled to any more protection against competition than it was able to obtain through patent grants that provided it with a considerable head start on potential competitors."[99]

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[95] In a separate development, the possibility of anti-competitive abuses providing a defence at law or grounds for denial of equitable relief was also referred to in the decisions of the Federal Court of Canada in *The Procter and Gamble Co.* v. *Kimberley-Clark of Canada Ltd.* See (1986), 12 C.P.R. (3d) 430 and (1989), 28 C.P.R. (3d) 226.

[96] For discussion, see Howard I. Wetston, *supra*, note 74. For background on the case, see *Canadian Competition Policy Record*, vol. 10, no. 2, June 1989.

[97] *Canada (Director of Investigation and Research) v. NutraSweet Co.* (1990) 32 C.P.R. (3d) 1 (Competition Tribunal, October 4, 1990), at pp. 38-41. In addition to the substantive merits of the NutraSweet matter, this decision provides the Tribunal's conclusions regarding important constitutional issues relating to its independence and impartiality. Essentially, the Tribunal held that the panel responsible for the NutraSweet matter was validly constituted in light of the relevant constitutional provisions and judicial doctrines.

[98] See *ibid.*, pp. 41-43. In its decision, the Tribunal also rejected certain allegations of the Director related to pricing below cost, contractual exclusion of a potential competitor and abuse of governmental reporting requirements.

It is noteworthy that notwithstanding the important role of intellectual property rights in the case, the Tribunal did not find it necessary in its decision to discuss the limited exception for such rights in section 79(5) of the Act. Consequently, it appears that the Tribunal has determined that this exception does not limit the application of the section to IPR-related contractual practices when they are deemed to constitute abuses.

Finally, regarding the tied selling issue, the Tribunal accepted that a trademark could, in principle, be part of a tying arrangement for the purposes of section 77 of the Competition Act. It was not, however, convinced that such argument was supported by the facts in the case. It may be noted that the Competition Tribunal's decision in the case is being appealed by the NutraSweet Company on various grounds.[100]

In sum, in the 1980s legislative and policy developments respecting the competition policy-intellectual property interface in Canada generally reflected trends evident in other jurisdictions. The attempts to toughen the existing remedial measures relating to patents, copyrights and trademarks that characterized the legislative proposals of the 1970s were dropped from Bills C-29 and C-91 which led to the *Competition Act* of 1986. This was consistent with the implications of the new antitrust thinking respecting IPRs and vertical market restraints. The 80s were not, however, a decade of inaction on the part of competition advocates respecting intellectual property issues in Canada. Interventions by the Director of Investigation and Research helped to shape the important revisions to the *Patent Act* (Bill C-22) and the *Copyright Act* (Bill C-60) during the decade. At the close of the decade, the Director's application and the decision of the Competition Tribunal in the *NutraSweet* matter under the new abuse of dominance provisions also illustrated continuing awareness of the need for application of competition policy to counteract perceived anti-competitive abuses associated with IPRs.

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[99] *Ibid.*, p. 52.

[100] The Company disagrees with important aspects of the Competition Tribunal's decision in the case. See "Tribunal ruling appealed," *Globe and Mail*, October 23, 1990, p. 83.

5.0 COMPETITION POLICY-INTELLECTUAL PROPERTY ISSUES FOR THE 1990s

In the 1990s, intellectual property rights and associated competition policy issues are likely to assume increased importance for Canadian growth prospects and international competitiveness. Modern technology has given rise to new species of intellectual property such as computer software and semiconductor chip designs. Increasingly, continued prosperity for Canada and other countries is seen as dependent on successful adaptation of such technology. With this awareness, there has been growing interest in IPRs and their implications for world trade and development in multilateral fora such as the General Agreement on Tariffs and Trade. Indeed, Trade Related Intellectual Property Rights (TRIPS) are a key focus of discussion in the ongoing Uruguay Round of Multilateral Trade Negotiations. Recently, there has been growing recognition of the importance of such deliberations and the potential benefits for Canada of more effective multilateral rules and dispute settlement procedures in this area.[101]

This part of the paper examines several issues involving the competition policy-intellectual property interface that are likely to be important in the new decade. Subsection 5.1 reviews the current treatment of technology licensing arrangements under the *Competition Act*, and contrasts their treatment in Canada with the situation in other parts of the industrialized world. Subsection 5.2 comments on Canadian interests with respect to recent multilateral developments relating to restrictive business practices and technology transfer. Subsection 5.3 considers the implications of the territorial divisibility of IPRs in Canada and abroad and the possible application of the principle of exhaustion of IPRs in international trade.

5.1 The Competition Policy Treatment of Technology Licensing Arrangements

IPR licensing arrangements are a major vehicle for dissemination of new technology.[102] It is important that competition law and policy in Canada provides an appropriate framework for technology licensing arrangements. In particular, competition law must seek to deal effectively with actual anti-competition abuses without interfering with efficiency-enhancing licensing practices.

The various provisions of the *Competition Act* discussed in the preceding sections of the paper provide the basis for a liberal case-by-case approach to licensing arrangements. The IPR remedy provisions as well as the general sections dealing with abuse of dominance and other reviewable matters incorporate thresholds that limit their application to practices that have specific anti-competitive effects. There is, however, a paucity of jurisprudence concerning the application of the *Competition Act* to specific IPR licensing practices.[103]

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[101] See Murray G. Smith, "Global Rivalry and Intellectual Property: Implications for Canadian Economic Policies," *supra*, note 76, and Howard I. Wetston, *supra*, note 74.

[102] The importance of licensing as a vehicle for the dissemination of technology is indicated in Consumer and Corporate Affairs Canada, *supra*, note 10.

The lack of case law or administrative guidance concerning the application of the *Competition Act* to IPR licensing arrangements is in contrast to the situation in other major industrialized jurisdictions such as the U.S., the European Community and Japan. In the U.S., there is an extensive body of jurisprudence dealing with restrictive licensing practices such as tie-ins, field-of-use restrictions, grant-backs, exclusive dealing requirements, no-contest clauses and post-patent royalties. In addition, the *Antitrust Guidelines on International Operations* issued by the Department of Justice in November 1988 discuss at some length the application of the U.S. antitrust laws to international licensing agreements.

In the U.S., the application of the antitrust laws to IPR abuses is also reinforced by extensive private antitrust litigation.[104] This reflects important institutional factors such as the scope for treble damage actions and contingency fees in antitrust cases. Finally, as noted, there has traditionally been broad scope in the U.S. for the use of alleged anti-competitive abuses as a defence in IPR infringement cases.

The competition policy treatment of restrictive licensing arrangements in the European Community (EC) has been clarified in regulations on patent and know-how licensing released by the EC Commission in 1984 and 1989, respectively.[105] The regulations set forth detailed standards for review of licensing agreements based on principles established in previous decisions by the Commission and the European Court of Justice under Article 85(1) of the *EEC Treaty (Treaty of Rome)*. The EC regulations are an important element of the economic policy framework for the Community and are consistent with the overriding EC goal of integrating the member countries' markets.[106]

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[103] One area of continuing uncertainty concerns whether IPRs constitute products coming under the exclusive dealing, market restriction and tied selling provisions of the *Competition Act*. For discussion of this and other pertinent issues, see Szibbo, *supra*, note 43, ch. 4.

[104] Anderson, Khosla and Ronayne, *The Competition Policy Treatment of Intellectual Property Licensing in the U.S. and Canada*, *supra*, note 75.

[105] See EEC Regulation No. 2349/84, On the application of Article 85(3) of the Treaty to certain categories of patent licensing agreements, CMR 2747, and EEC Regulation No. 556/89, On the application of Article 85(3) of the Treaty to certain categories of know-how licensing agreements, CMR 2771.

Patent or know-how licensing agreements are dealt with under the EC regulations in one of three ways. First, agreements that contain only the restrictive clauses listed in Articles 1 and 2 of the regulations are granted an automatic exemption from Article 85(1) of the *EEC Treaty*. The types of restrictions that are given an automatic exemption under Articles 1 and 2 include: (i) exclusive licences for territories within the EC but not preventing parallel trade between these territories; (ii) tie-ins and minimum quality standards that are justified on technical grounds; (iii) minimum royalty requirements; (iv) reciprocal non-exclusive grant-backs relating to improvements or new applications of licensed technology; and (v) field-of-use restrictions.

Second, licensing agreements containing restrictive clauses that are listed in Article 3 of the regulations are specifically denied the benefit of an exemption from Article 85(1) of the *EEC Treaty* on the basis that they are unlikely "to lead to the positive effects required by Article 85(3)." While these practices are not prohibited *per se* under the regulations, in practice they are likely to be prohibited in cases where they impede trade between EC member states.[107] The specific licensing practices that are "black-listed" in Article (3) include provisions: (i) preventing licensees from challenging the validity of licensed patents; (ii) allowing the licensor to extend the life of an agreement unilaterally; (iii) restricting markets or customers in a manner not exempted under either Article 1 or 2 of the regulations; (iv) basing royalties on products not embodying licensed IPRs; (v) establishing quantity or price restrictions; (vi) compelling the acquisition of products or IPRs other than those that are necessary on technical grounds; (vii) imposing unilateral grant-back requirements; or (viii) preventing legitimate parallel trade within the EC "without any objectively justified reason."

Finally, licensing agreements containing restrictive clauses not covered by Articles 1 to 3 of the regulations, while not entitled to an outright exemption, are subject to an expedited procedure for approval under Article 4. Under this procedure, licensing agreements that are notified to the Commission and are not challenged during the following 60 days are presumed exempt from Article 85(1) of the *EEC Treaty*. Agreements examined under this procedure are likely to be evaluated on a case-by-case basis.

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[106] For discussion of the EC competition policy treatment of IPR licensing, see Barry E. Hawk, *United States, Common Market and International Antitrust: A Comparative Guide* (Clifton, New Jersey: Prentice Hall Law & Business, Inc./Harcourt Brace Jovanovich Publishers, 1987), vol. III.

[107] See, e.g., Michael L. Coleman and Dieter A. Schmitz, "The EEC Patent licensing Regulation - Practical Guidelines," *The Business Lawyer*, vol. 42, November 1986.

The treatment of patent and know-how licensing practices under Japan's competition legislation, the *Antimonopoly Act*, has also recently been revised and clarified. A new set of *Guidelines for the Regulation of Unfair Trade Practices with Respect to Patent and Know-How Licensing Agreements*, approved by the Japanese Fair Trade Commission (FTC) in February 1989, has established fairly detailed standards to govern a number of specific licensing practices. The new Guidelines replace a previous set of *Guidelines for International Technology Introduction Agreements* issued in 1968.[108] They are intended to facilitate international technology transfer by providing greater transparency in the FTC's treatment of technology transfer arrangements.[109]

The new Japanese Guidelines establish three categories of restrictions relating to patent and know-how licensing: (i) restrictions which are considered, in principle, not to constitute unfair trade practices; (ii) restrictions which may or may not be considered as unfair trade practices, depending on their market effects; and (iii) restrictions which are highly likely to be treated as unfair trade practices, unless specific justification is shown by the parties. Restrictions which are found to constitute unfair trade practices are subject to prohibition under section 6 of the Japanese *Antimonopoly Act*.

Licensing restrictions included in the first category (i.e., those not generally considered to constitute unfair trade practices) include: (i) limitations on the area covered by a licensing agreement; (ii) field-of-use restrictions; (iii) conditions requiring minimum production, sales or use of patented technology; (iv) non-exclusive grant-back clauses where the agreement imposes similar obligations on both parties; (v) tie-in requirements that are necessary to maintain goodwill or ensure the effectiveness of the licensed technology; (vi) certain package licensing requirements; and (vii) conditions stipulating that a licensor may terminate a licensing agreement if the licensee challenges the validity of a licensed patent.

Practices falling into the second category (i.e., those which may or may not be treated as unfair trade practices, depending on their competitive effects in the market(s) affected) include: (i) convenants not to handle competing goods or use competing technology while a licensing agreement is in force; (ii) exclusive selling requirements; (iii) grant-back conditions that do not place equal obligations on both parties; (iv) requirements to use the licensor's trademark; (v) the imposition of production or input quality standards that are

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108. For an overview of the new Guidelines, see Hideki Ogawa, "New Technology Licensing Guidelines in Japan," *World Competition Law and Economics Review*, vol. 13, no. 2, December 1989, pp. 63-68. The philosophy underlying the Japanese guidelines is discussed in Joel Davidow, "The New Japanese Guidelines on Unfair Practices in Patent and Know-How Licences: An American View," *World Competition Law and Economics Review*, vol. 12, no. 4, June 1989, pp. 5-22.

109. For commentary, see Davidow, *ibid*.

not necessary to maintain the effectiveness of a patent or the goodwill of a trademark; (vi) exclusive supply requirements; and (vii) restrictions on the right of licensees to export patented goods. It should be noted, however, that the latter practice will not be treated as an unfair trade practice in situations where: (i) the licensor has registered his patent rights in the area to which the licensee is exporting; (ii) the licensor has been continually marketing patented goods in the area concerned; or (iii) the licensor has assigned the area as an exclusive sales territory for a third party.

Licensing practices falling in the third category (i.e., those likely to be treated as unfair trade practices, unless specific justification is provided) include: (i) restrictions on the prices at which patented goods are sold in Japan; (ii) covenants not to handle competing goods, or to use competing technology, following the expiration of the licensing agreement; (iii) requirements for payment of royalties following expiration of a patent; (iv) restrictions on R&D activities relating to a licensed patent or competing technology; and (v) exclusive grant-back requirements that prohibit a licensee from using improvements that he may make on the licensor's patented technology.

A case can be made that Canada should consider following the example of the U.S., EC and Japan by developing its own set of IPR licensing guidelines.[110] This is not to suggest that the content of any Canadian guidelines should necessarily follow any of these jurisdictions' approach. In both the EC and Japan, the recent guidelines have been shaped by national economic policy considerations that are not necessarily shared by Canada.[111]

The basis for an appropriate set of guidelines is already present in the various provisions of the *Competition Act* applicable to IPRs. A set of guidelines would, however, help alleviate the uncertainty attributed to the lack of jurisprudence in this area. In developing the guidelines, consideration should be given to Canada's status as a net importer of technology as well as the current thinking concerning technology licensing arrangements and antitrust policy.

5.2 Multilateral Developments Concerning International Technology Transfer

The treatment of restrictive licensing practices in international technology transfer agreements has also been the subject of discussion in various multilateral fora, including UNCTAD, the OECD and the OAS, over the past several years.[112] In the course of these discussions, a number of developing countries have called for the implementation of multilateral measures to regulate the use of restrictive practices in international licensing agreements on the basis that these practices constitute a barrier to trade. Specifically, these countries have advocated the adoption of international technology transfer regulations prohibiting or strictly regulating restrictive practices such as tie-ins, exclusive grant-backs, package licensing, and quantity and price restrictions.[113]

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[110] For related discussion, see Howard I. Wetston, *supra*, note 74.

[111] For example, it has been suggested that the Japanese Guidelines are slanted towards promoting the development of indigenous technological capability at the expense of consumer interest. See Davidow, *supra*, note 108.

To some extent, Canada shares the concerns underlying the calls for technology transfer guidelines that have been made by developing countries. Like these countries, Canada relies heavily on imported technology. Indeed, from 1972 to 1987, Canada was the country of inventor for only 7% of total patents granted in Canada. In other major industrialized countries, residents generally account for 20% to 50% of total patents granted.[114]

Nevertheless, the adoption of a strict multilateral code on the use of restrictive practices in international technology transfer agreements as proposed by the developing countries would not be in Canada's interest. As discussed above, apart from cartel arrangements between firms, which should be subject to strict treatment under national competition laws, many restrictive licensing practices are not necessarily harmful to competition and even serve valid efficiency-related functions. Such practices should be treated only on a case-by-case basis.

A strict or *per se* approach to restrictive practices in a multilateral agreement relating to technology licensing would raise the costs and/or undermine the incentives for technology owners to enter into voluntary licensing or other arrangements with users.[115] Voluntary arrangements are, in general, more likely to promote the host country's technological advancement than compulsory measures, since they are more often accompanied by a transfer of know-how and capital investment.

It may also be noted that restrictive clauses in commercial licensing agreements are different from the barriers to trade that have normally been dealt with under the GATT. Tariffs and conventional non-tariff barriers are non-discretionary measures that distort the relative prices of imports in relation to domestic production. Such measures affect directly the incentives for efficient international trade versus domestic production of goods and services. In contrast, restrictive licensing practices, because they are discretionary commercial practices, do not necessarily interfere with either the incentive or the ability of IPR owners to organize their production activities efficiently.[116]

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[112] Susan S. Holland (Editor), *Codes of Conduct for the Transfer of Technology: A Critique* (New York, N.Y.: Council of the Americas and Fund for Multinational Management Education, 1976), p. vii.

[113] See, e.g., Wolfgang Fikentscher, *The Draft International Code of Conduct on the Transfer of Technology* (Munich: Max Planck Institute for Foreign and International Patent, Copyright, and Competition Law, 1980).

[114] See Consumer and Corporate Affairs Canada, *supra*, note 10, pp. 5-6.

[115] For related discussion, see J.P. Palmer and R.J. Aiello, *supra*, note 11 and references cited therein.

5.3 Intellectual Property Rights and International Market Segmentation

The role of intellectual property rights in the international segmentation of markets and the resulting tendency to facilitate international price discrimination is a perennial concern of Canadian policy makers.[117] This role arises from the ability of patent and copyright holders in many circumstances to bar the parallel importation of duly authorized foreign versions of their products.[118] This ability has long been an important aspect of IPR protection in Canada and abroad and, arguably, is necessary to the maintenance of differing national intellectual property regimes. Nevertheless, in the era of the globalization of markets, continued market segmentation based on the territorial divisibility of IPRs may be viewed as inconsistent with the general trend toward freer movement of goods, services and capital across international boundaries.

The principle of exhaustion of intellectual property rights in international trade is a possible means of addressing this issue. In general terms, exhaustion refers to the removal of the existing rights of intellectual property holders to control parallel imports of products embodying their intellectual property. More formally, it provides that the first sale of an article embodying intellectual property "exhausts" the right of the IPR owner to control the terms and conditions of resale. The principle of exhaustion already applies within certain jurisdictions (e.g., the U.S. and the EC), but is not generally applicable to the movement of patented or copyrighted goods across international boundaries.[119] Application of this principle to Canada's external trade has, however, been proposed at varying times by the Economic Council of Canada, the Department of Consumer and Corporate Affairs (in proposed amendments to Canadian trademark and patent legislation in 1974 and 1976, respectively), and various academic commentators.[120]

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[116] For related discussion, see R.D. Anderson, P.J. Hughes, S.D. Khosla and M.F. Ronayne, *Intellectual Property Rights and International Market Segmentation: Implications of the Exhaustion Principle* (Hull, Quebec: Bureau of Competition Policy, Economics and International Affairs Branch, Working Paper, October 1990).

[117] As noted in Part III, concerns about international price discrimination were a major part of the rationale for the 1969 amendments to the *Patent Act*, which strengthened the compulsory drug patent licensing provisions. Concerns of this nature were also noted in Economic Council of Canada, *Interim Report on Intellectual Property* (Ottawa: Information Canada, 1971), p. 90 and in Commissioner, *Combines Investigation Act*, *supra*, note 32, especially at pp. 22-24.

[118] For background, see Robert H. Barrigar, "Intellectual Property and the Distribution of Goods," in Robert H. Barrigar, ed., *Product Distribution* (Vancouver, B.C.: Materials prepared for a Seminar by the B.C. Continuing Legal Education Society, October 1988), at pp. 1.1.27 to 1.1.38. See also Howard P. Knopf, "*Seiko* v. *Consumers Distributing*: More Shades of Grey Marketing Law," *Intellectual Property Journal*, vol. 1, no. 3, June 1985, pp. 337-55.

A recent study of these matters prepared in the Bureau of Competition Policy suggests that the implications of exhaustion and international market segmentation through IPRs are more complex than was previously understood. To begin with, the study indicates that the economic effects of exhaustion depend importantly on underlying legal and institutional issues.[121] One key issue is the legal regime applicable to contractual restrictions on exports by subsidiaries/licensees. Where such restraints are permitted, they provide an alternative means of controlling parallel international trade in goods embodying IPRs.

The availability of contractual or licensing parallel trade restraints varies significantly between countries. Major developed countries, such as the U.S., Japan and Canada, tend to provide relatively permissive treatment to vertical contractual restraints of parallel trade. Major developing countries, in contrast, tend to favor strict treatment of contractual or licensing restrictions of their international trade.[122]

It should also be noted that there are significant differences between contractual restraints and IPR-based import control rights that limit their substitutability. Unlike the latter, the former normally provide the owner of the rights with the ability to take action against any unauthorized parallel importation of the relevant products whether or not it involves persons that are party to any licensing or contractual arrangements with the rights owner.[123] In contrast, in order for contractual or licensing restraints to be directly applicable to parallel trade, this trade must normally involve someone having contractual or licensing relations ("privity of contract") with the owner.

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[119] Anderson, Hughes, Khosla and Ronayne, *supra*, note 116, Ch. II. Regarding the application of exhaustion with respect to trademark goods, see Barrigar, *id*. and Knopf, *id*. For discussion of the application of exhaustion to intra-EEC trade, see, generally, Paul Demaret, *Patents, Territorial Restrictions and EEC Law* (Munich: Max Planck Institute for Foreign and International Patent, Copyright, and Competition Law, 1978).

[120] Economic Council of Canada, *supra*, note 117, p. 90, Consumer and Corporate Affairs Canada, *supra*, note 3, pp. 141-42 and Consumer and Corporate Affairs Canada, *Working Paper on Trade Marks Law Revision* (Ottawa: Supply and Services Canada, January, 1974), ch. 7 and Ake Blomqvist and Chin Lim, *Copyright, Competition and Canadian Culture: The Impact of Alternative Copyright Act Import Provisions on the Book Publishing and Sound Recording Industries* (Consumer and Corporate Affairs Canada, Copyright Revision Series, 1981).

[121] Anderson, Hughes, Khosla and Ronayne, *supra*, note 116.

[122] Individual developing country's laws and regulations concerning the use of export restraints in technology transfer agreements are listed in United Nations Conference on Trade and Development, *Control of Restrictive Practices in Transfer of Technology Transactions* (New York: United Nations, 1982), ch. XIII.

The substitutability of contractual restraints for import control rights may also be limited by the different manner by which these restraints are enforced. Contractual restraints are generally enforced in civil courts in the country in which the breach of contract occurs. This may entail higher costs than the enforcement of rights-based parallel trade restraints through infringement actions. Accordingly, it should be expected that the implementation of exhaustion in any situation will be accompanied by at least some reduction in the ability of IPR-owners to segregate markets.

In terms of economic implications, an important finding of the above-noted study is that import control rights derived under intellectual property legislation do not constitute a barrier to trade in the traditional sense.[124] Unlike tariffs or traditional non-tariff barriers, such rights do not remove either the ability or the incentive of firms to realize gains from rationalization of their production activities. The study indicates that wide implementation of the exhaustion principle in international trade would be unlikely to have beneficial effects on average consumer prices across industries. It could also erode the incentive for rapid transfer of foreign-developed technology by multinational enterprises into host countries such as Canada.[125]

Implementing exhaustion on a multilateral basis would also have major institutional repercussions. For example, multilateral exhaustion would probably necessitate substantial harmonization of international standards of IPR protection.[126] This might include curtailment of existing Canadian compulsory licensing provisions (especially sections 67 and 41(4) of the *Patent Act*), since, under exhaustion, licences granted under these provisions could be used to undermine the integrity of IPRs in other countries. At a minimum, products manufactured under such provisions might have to be exempted from the exhaustion regime.

In sum, it is important that Canada consider closely the costs as well as the benefits of implementing exhaustion of IPRs in international trade. Implementation of exhaustion at the multilateral level across all industries is unlikely to be to Canada's advantage. Such a policy would have only a limited impact on the overall level of consumer prices and could undermine the incentive for efficient transfer of technology into Canada. It would be desirable, however, to give further consideration to the implications of implementing exhaustion bilaterally between Canada and the U.S. It is possible that this might entail somewhat lower costs than in the multilateral context, owing to the broad similarities in the approaches to IP protection in the two countries. In addition, bilateral exhaustion might provide significant benefits to Canadian industries by reducing the threat posed by possible application of U.S. trade remedies, such as section 337 of the *Tariff Act*, to exports of IPR-embodying goods.

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[123] For discussion of this issue, see Anderson, Hughes, Khosla and Ronayne, *supra*, note 116, ch. I.

[124] Anderson, Hughes, Khosla and Ronayne, *supra*, note 116, ch. IV.

[125] In this regard, see also William L. Hayhurst, "Intellectual Property and Distribution Issues," in Proceedings of a Conference sponsored by the Canadian Institute on *Competition Policy in North America: Implications of the U.S./Canada Free Trade Agreement* (January 27, 1989).

[126] Anderson, Hughes, Khosla and Ronayne, *supra*, note 116.

6.0 CONCLUDING REMARKS

The treatment of intellectual property has been an important consideration in the 100 year history of competition policy in Canada. In the pre-World War II period, IPRs figured prominently in Parliamentary debates and constitutional litigation concerning Canadian competition legislation. The legislative provisions and judicial decisions of this period were generally supportive of the role of intellectual property vis-a-vis competition policy. In the 1960s and 1970s, there were major efforts by competition authorities to constrain the exercise of IPRs through strict application of competition law and related policy initiatives. These efforts paralleled developments in other jurisdictions (especially the U.S.) and reflected the prevailing sceptical view regarding the role of IPRs in a competitive economy.

The 1980s saw, in some respects, a return to a more favourable competition policy approach to IPRs. The new perspective reflected improved understanding of the role of IPRs in promoting dynamic competition and the potential efficiency benefits of restrictive licensing practices. This approach was reflected in the 1986 amendments to the *Competition Act* and in related amendments to the *Patent Act* and the *Copyright Act* which involved the weighing of static and dynamic efficiency considerations.

The current provisions of the *Competition Act*, particularly in light of the 1975 and 1986 amendments, provide the basis for a balanced approach to the treatment of IPR abuses. The treatment of abuse of IPRs under these provisions, which is based upon a case-by-case analysis, is consistent with current economic thinking. This approach enables competition authorities to take effective action against anti-competitive abuses of IPRs without interfering in legitimate commercial transactions.

In the 1990s, the accelerating pace of technological change in conjunction with the globalization of markets will pose major challenges for Canadian competition policy in relation to intellectual property issues. To begin with, the 1990s may well witness the development of new intellectual property regimes to cover emerging areas of inventive activity (e.g., biotechnology). It is important that competition authorities participate in the development of these regimes, to ensure an appropriate interface with competition law and policy.

In addition, Canadian competition authorities have an important role to play in providing input to international deliberations relating to competition policy-IPR issues. In the context of such discussions, various developing countries have called for strict measures to regulate international licensing practices. A strict code would, however, be adverse to Canadian interests in that it would raise the costs and/or undermine the incentives for technology owners to enter into voluntary licensing arrangements with users. Another issue requiring competition policy input concerns the role of intellectual property rights in facilitating international price discrimination and market segmentation.

In sum, the exercise of intellectual property rights has long been, and is likely to remain, a major focus of interest for Canadian competition authorities. The issues to be dealt with in future, however, will no longer concern the fundamental compatibility of IPRs with competition policy. In the 1990s, there will be increasing interest in international aspects of IPR protection and the extension of such protection to new types of technology. The challenge for Canada will be to ensure that a competition policy framework is in place that adequately reflects developments related to these trends and facilitates pro-competitive use of IPRs while permitting effective action to be taken against genuine anti-competitive abuses.

Chapter 24

THE IMPACT OF THE COMPETITION ACT OF 1986

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1.0 INTRODUCTION

In September, 1989, *The Economist* carried an article on U.S. antitrust enforcement in today's world marketplace. The suggestion was made that their antitrust laws needed to be amended to recognize the changes in their economic environment. The article went on to say that it is "easy to say that America's antitrust laws should be updated, but hard to do." Those familiar with the Canadian experience in designing and updating our own competition law and policy would no doubt agree wholeheartedly with such observations in a generic sense.

Nevertheless, we in Canada have succeeded in completing a difficult task that other nations are continuing, or are only beginning to tackle. The Canadian Parliament, in 1889, was the first national government to implement laws addressing antitrust infractions. One could describe the subsequent 97 year period up to 1986, as a strenuous path to reform (see Sanderson and Stanbury, 1989). Indeed, the *Competition Act* passed in June 1986 was, itself, the culmination of almost twenty years of concerted effort by our legislators (see Clark, 1991). In the period since 1986, a quiet revolution has taken place in the protection of competition in this country. This revolution has come about partly because of the nature of the *Competition Act* itself -- it is a modern and realistic framework for addressing antitrust issues -- and partly because of the approach the Bureau of Competition Policy has adopted to enforce the legislation.

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[1] Ed. Note: Effective October 29, 1989 Mr. Goldman resigned to return to the practice of law in Toronto (Davies, Ward & Beck) and was replaced by Howard Wetston, the former Deputy Director. See *Canadian Competition Policy Record*, Vol. 10(3), 1989, pp. 1-2.

The design objective in the drafting of the *Competition Act* was, in a word, balance. The legislators set out to write a law that would effectively discourage and prohibit practices which harm competition. But they also recognized the need to do so without placing crippling constraints on Canadian industries' ability to compete in international markets.

Important themes reflected throughout the *Act* -- efficiency, adaptability and international competitiveness -- recognize the realities of the Canadian economy. It is an economy characterized by smaller companies relative to most other industrialized nations, high levels of market concentration in small, geographically-segmented domestic markets, and businesses which may require an opportunity to rationalize production to be competitive in offshore markets.

Given these fundamental characteristics, effective competition legislation must balance two broad economic interests that are particularly important at this point in Canada's history. We need to ensure that competition is maintained and encouraged in domestic markets and, at the same time, we need to enhance our efficiency and our international competitiveness. The experience of the past three years, which is the focus of this paper, demonstrates that the *Competition Act* is well suited to this delicate balancing task.

In this paper I do not discuss the administrative changes in the Bureau of Competition Policy on which we have spent a good deal of time and which I have discussed on earlier occasions.[2] Simply put, we undertook these changes to ensure that we were operating as efficiently and effectively as possible to meet the objectives of the *Act*.

2.0 THE COMPLIANCE-ORIENTED APPROACH AND MERGER REVIEW

The *Competition Act* allows for the use of a variety of techniques to resolve competition concerns short of litigation in both criminal and reviewable matters. Accordingly, by its nature, the present legislation permits the Bureau to adopt what we have termed our "compliance-oriented approach" to the enforcement of its provisions. We have concentrated our efforts in two ways: firstly, in the promotion of continuing voluntary compliance; and, secondly, by relying on a broader range of responses to non-compliance (Director of Investigation and Research, 1989). By effectively addressing appropriate cases in this manner, the Bureau has been able to focus its resources on cases of greater potential economic significance, consumer benefit or deterrent effect. Clearly, initiating contested proceedings is not the answer in many situations, and particularly not when alternative means are available to provide equally effective, more timely and less costly resolutions. Just as in the medical profession where it is a lot more efficient and effective to practice preventative medicine than to always embark on surgery -- similarly preventative compliance may obviate the need for costly and time-consuming litigation -- but we will certainly go to litigation if necessary.[3]

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[2] See Goldman (1986a), (1986c), (1986d), (1987d), (1988a), (1988e), (1989c), (1989d) and *Canadian Competition Policy Record*, Vo.. 8(4), 1987, pp. 10-11.

Over the past three years since the new provisions were enacted, we have maintained an open door policy to encourage an ongoing exchange of views and to increase the level of compliance with the legislation. This aspect of our compliance-oriented approach is working to the point now that our two boardrooms are regularly visited by representatives of the private sector regarding case matters.

The availability of alternative resolution techniques has been particularly useful in working the anticompetitive features out of merger proposals. The Bureau's compliance-oriented approach to merger review, with its emphasis on "fix-it-first" restructuring, has proved to be of great benefit in meeting the objectives of the *Competition Act*.[4] Moreover, the flexibility of this approach is well suited to particular merger review issues in the present environment where many businesses in Canada are having to meet the new challenges of increasingly globalized trade and increased international competition.

2.1 Instruments to Facilitate Compliance

Two of the most direct ways in which we attempt to facilitate compliance with the merger law are the provision of advisory opinions on proposed mergers and the issuance of advance ruling certificates. These instruments allow the parties to a merger to come to the Bureau of Competition Policy at the proposal stage, to learn in advance how we are likely to view its effects on competition. If the proposal is one that will not likely substantially prevent or lessen competition, an advance ruling certificate may be issued which allows the merger to proceed with statutory comfort. If the proposal cannot meet this test, the parties may be provided with an advisory opinion that highlights either our present concerns or possible future concerns.

Another pre-emptive feature is the requirement for pre-closing notification. Above specified thresholds of value, companies planning to merge must tell us in advance (see Part IX of the *Act*, S.108 *et seq.*). Pre-closing notification enables us to examine the transaction before it is completed to determine whether it raises an issue under the *Act*. Whether or not a proposed merger is notifiable, we certainly encourage business to consult with us well in advance of the closing date to determine if an issue is likely to arise under the *Act*. The *Act* applies to mergers of all sizes, whether or not the transaction is notifiable.

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[3] Critiques are offered by Maule and Ross (1989) and by Stanbury (1991).

[4] Between June 19, 1986 and March 28, 1991 the Bureau completed three merger cases with pre-closing restructuring and seven with post-closing restructuring. See *Canadian Competition Policy Record*, Vol. 12(1), 1991, p. 9.

If the future effects of a merger are not sufficiently predictable, we may decide to monitor the results of the merger. Section 97 of the *Act* gives the Bureau three years to move against a merger if in that time it is determined that it substantially prevents or lessens competition or is likely to do so. At any time in these three years, if negative effects emerge, we can assess them and take steps to curb them.[5]

I emphasize that the focal point of our merger process is the making of decisions which are fully informed. As a matter of policy we enlist the aid of industry and other outside experts. We seek information from many sources to ensure that we arrive at an accurate, real-world assessment of the likely effects of a merger.

2.2 Alternative Routes

When we are faced with a merger that will likely prevent or lessen competition substantially in Canada, there are several routes we can follow to resolve our concerns short of litigation. Our preferred approach, as I've said, is to "fix-it-first." Typically, this involves a restructuring of the transaction before closing, for instance through divestiture, to remove the undesirable features of the proposal and so remove the basis upon which we could launch a challenge. I should emphasize that restructuring of proposed mergers is only done where the parties themselves take the initiative after we have made our concerns known -- it is their choice. They remain free to decline any such restructuring and have the issues addressed in contested proceedings before the Competition Tribunal.

Where restructuring is not possible before closing, post-closing restructuring can be accommodated. In such cases, one alternative is to proceed to the Tribunal on the basis of an application for an order on consent approving the resolution arrived at with the parties. In other instances we may allow the merger to proceed without immediate challenge, but subject to an undertaking by the parties involved to take specific action by a specified date to deal with our concerns. Generally, we require those giving undertakings also to consent to an order that may be issued by the Tribunal in the event that the undertakings are not fulfilled.[6]

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[5] Between June 19, 1986 and March 28, 1991 the Bureau concluded 44 merger cases by saying it would monitor the firms and the industry. See *Canadian Competition Policy Record*, Vol. 12(1), 1991, p. 9.

[6] The criteria are discussed in Goldman (1989c) and *Canadian Competition Policy Record*, Vol. 10(2), 1989, pp. 47-55.

2.3 Assess Effects on Competition and Efficiency

In our assessment of the impact of a merger under the *Competition Act*, we try to be as realistic as possible. The competitive implications of a merger cannot be assessed solely on the basis of industry concentration or the market shares of the participants.[7] Simple quantitative criteria such as concentration ratios are not determinative. The *Act* requires us to consider a whole range of other "qualitative" factors. These include the extent of effective foreign competition; the possibility of a failing business; the availability of acceptable product substitutes; the existence of any trade, regulatory or other barriers to entry; the extent of effective competition remaining in the market; whether the merger is likely to result in the removal of a vigorous and effective competitor; the nature and extent of innovation and any other factor that is relevant to competition in a market. (See S. 93.)

In addition, it is not only the negative effects on competition which are considered in merger review, but also the benefits for the Canadian economy flowing from more efficient industry. An efficiency exception for mergers was incorporated in the 1986 *Act* (S. 96). Mergers are not to be blocked if they bring about gains in efficiency that will be greater than, and will offset, the effects of any lessening of competition resulting from the merger, and if such efficiency gains would not likely be attained if an order blocking the merger were made. In short, the *Act* requires that we examine a merger from a practical and real-world economic perspective (see Director of Investigation and Research, 1991, Part 5).

This examination of offsetting benefits is an important feature of another aspect of the *Act* -- the provisions relating to specialization agreements (S. 85-90). Such agreements are particularly important to Canada's manufacturing sector because of the relatively large number of small scale plants. Specialization agreements will likely figure prominently in corporate strategies for adapting to markets that are becoming increasingly more global pursuant to GATT discussions. And they may play an important part in the Canada-U.S. free trade environment.[8] Under the old *Act*, companies contemplating an arrangement of this kind faced a powerful deterrent. Specialization agreements could have been viewed as violations, perhaps even criminal conspiracies. These agreements now offer an available option to companies that do not want to go the whole extent of a merger to remain competitive in the global marketplace.

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[7] See the paper by Crampton in Part 3 of this volume and Director of Investigation and Research (1991).

[8] See Goldman (1988g), (1989a) and Rosenthal (1989).

3.0 HIGHLIGHTS OF BUREAU ACTIVITIES

3.1 Merger Cases

I have outlined only a few of the more significant merger and related features of the *Competition Act*, which should be sufficient to indicate that the legislation definitely represents a step forward in a modern and realistic direction. The proof of the law's effectiveness is on the record as the following examples indicate.

Nabisco-Interbake: One of the first pre-closing "fix-it-first" resolutions achieved was the proposed takeover by Nabisco Brands Ltd. of certain assets of the Interbake Foods division of Weston Foods Ltd.[9] Our review covered a variety of factors including the influence of foreign competition and barriers to entry. We informed the two companies of our view that the merger as initially proposed would likely lessen competition substantially in the cookie and cracker markets, and that if they went ahead with it in that form, it would be challenged before the Tribunal. In response they presented us with a modified plan. Nabisco would acquire only those Interbake brands which made up a majority of its export sales. Interbake would find an alternate buyer for the remainder of the assets.

With these changes, the objectionable features of the transaction disappeared while the aspects that facilitated the attainment of increased international competitiveness were retained. Only then was the merger allowed to proceed unchallenged. The alternate buyer, as it turned out, was a Canadian company which is much smaller than either Nabisco or Weston. This illustrates a further advantage of the compliance-oriented process -- the generation of a new opportunity for small and medium-sized business.

Canada Safeway-Woodward's: A second resolution involved the proposed acquisition by Canada Safeway Limited of certain assets of Woodward Stores Limited.[10] We made it clear that this transaction would be challenged because of its likely impact on competition in six urban markets in Alberta and British Columbia. Safeway responded with an undertaking to divest itself of 14 supermarkets in the affected markets. It is interesting to note that smaller enterprises have managed to purchase many of those supermarkets in order to gain entry into the market or expand their presence.

Hostess-Frito-Lay: A further example arises from the Hostess/Frito-Lay partnership. We informed the parties in 1988 that the proposed transaction in its original form would likely lessen competition substantially in the salted snack food market.[11] In addressing our concerns, they restructured the transaction so as to divest a plant, trucks and equipment and the rights to seven brands to a third party: Murphy Snack Foods.[12] Once again, a new opportunity for a smaller enterprise in Canada was created as a result of the operation of the *Act*. This resolution received overwhelming support from major retailers, wholesalers and distributors in the industry across the country. And some of those retailers also have provided Murphy's with that essential ingredient to compete in that industry -- shelf space.

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[9] See *Canadian Competition Policy Record*, Vol. 9(1), 1988, pp. 6-7.

[10] See *Canadian Competition Policy Record*, Vol. 8(2), 1987, pp. 7-8 and Vol. 9(4), 1988, p. 10.

[11] See *Canadian Competition Policy Record*, Vol. 9(4), 1988, pp. 9-10.

Baxter-McKay's: The acquisition in New Brunswick by Baxter Foods Limited of McKay's Dairy Limited was abandoned as a consequence of our announced intention to challenge the proposal before the Tribunal.[13] Indeed, the end result was pro-competitive since McKay's Dairy was subsequently sold to Perfection Foods Limited, a smaller dairy in New Brunswick.

ABB-Westinghouse: On a much larger scale, Asea Brown Boveri Inc.'s proposed acquisition of various assets of Westinghouse Canada Inc. was a merger that involved a settlement subsequent to the public announcement of my intention to challenge the transaction before the Tribunal.[14] That merger and the merger of the computer reservation systems of Air Canada and Canadian Airlines International (the *Gemini* case), which was initially contested through extensive litigation, were settled on the basis of precedential consent orders (see below).

We used the consent order remedy with respect to the ABB/Westinghouse transaction to obtain what we consider to be a balanced settlement in relation to the market for electric power transmission and distribution facilities. This was a particularly complex situation in which simplistic approaches would not have worked. To achieve the dual goals I have mentioned, we needed a resolution that took into account a variety of domestic and foreign competition considerations. The resolution achieved reflects the kind of interaction we can expect to see more of between trade policy and competition policy.

We were able to achieve such a balance because the *Act* allowed us to consider real-world economic factors, in other words, to give appropriate weight to the dynamic nature of the market in question. This included the impact that both the Canada-U.S. Free Trade Agreement and ABB's commitment to seek a combination of tariff remission and accelerated tariff reduction would have in reducing barriers to entry and facilitating increased foreign competition. The order in effect says that ABB must obtain for the middle category of transformers tariff reductions on an accelerated basis under the Free Trade Agreement, and full tariff remissions for at least five years for the largest category of transformers, failing which divestitures are required.

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[12] Ed. Note: Unfortunately, Murphy became bankrupt in 1990.

[13] *Canadian Competition Policy Record*, Vol. 10(2), 1989, p. 17.

[14] See *Canadian Competition Policy Record*, Vol. 10(1), 1989, p. 8; Vol. 10(2), 1989, pp. 10-11; Vol. 10(3), 1989, p. 9; Vol. 10(4), pp. 12-13.

The consent order enables us to ensure that domestic market power will be constrained by foreign competition; at the same time, it encourages innovative activity in Canada and fosters the attainment of efficiencies that will allow ABB to better compete against foreign competition both domestically and abroad.

There is an additional point to note: despite the intricacy of the transaction, from the filing date of the proposed consent order before the Tribunal to the issuance of the order, the resolution took only seven weeks -- including just a half-day of hearings during which counsel for the Bureau responded to comments made by market participants. This was the first case in which a consent order was issued by the Tribunal.

The reasons for the Tribunal's decision in this case were released in September 1989.[15] In those reasons, Mr. Justice Strayer pointed out that a settlement arrangement between the Director and private parties is to be given considerable weight in the Tribunal's evaluation of a proposed consent order. The Tribunal indicated that it is fully cognizant of the savings in the resolution of matters as opposed to litigation and views such settlements as being in the public interest. I think it is fair to say that those reasons provide support for the merits and potential benefits of our compliance-oriented approach to merger cases.

Gemini: Another milestone was the *Gemini* case. In that case, contested litigation had already proceeded for about a year before the proposed consent order was agreed to and submitted to the Tribunal.[16] I characterize the case as a milestone because the Tribunal, in granting the consent order, clarified its role with respect to the issuance of such orders, thereby providing important guidance for both the Bureau and merging parties.

The Tribunal made it clear that although its role is not to rubber-stamp proposed orders, neither is it given a mandate to craft the best possible terms and conditions for protecting competition.[17] The Tribunal referred to the Ontario Supreme Court's decision in the *Sparling* case where the court recognized (under a different federal statute) that "settlements are by their very nature compromises, which need not and usually do not satisfy every single concern of all parties affected."[18]

The Tribunal said that its role is not to ask whether the terms of a consent order represent the optimum solution to a given problem, but is rather to determine whether the consent order meets a minimum test of ensuring that there will be no likelihood of a substantial prevention or lessening of competition. The Tribunal also indicated its willingness to consider behavioural type orders in certain circumstances.

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[15] See *Canadian Competition Policy Record*, Vol. 10(3), 1989, p. 9.

[16] See *Canadian Competition Policy Record*, Vol. 9(1), 1988, pp. 1-3; Vol. 9(2), 1988, pp. 3-5; Vol. 9(3), 1988, pp. 1-3, 9-10; Vol. 9(4), 1988, p. 24; Vol. 10(1), 1989, pp. 2-3; Vol. 10(2), 1989, p. 4; Vol. 10(3), 1989, pp. 4-6.

[17] Director of Investigation and Research v. Air Canada, Competition Tribunal, July 7, 1989 (CT-88/1). See *Canadian Competition Policy Record*, Vol. 10(3), 1989, pp. 4-6.

[18] *Sparling* v. *Southam Inc.* (1988) 66 O.R. (2d) 255 (HC) at p. 230.

Foreign Competition, Barriers, etc.: As I have mentioned, the statute states that a determination that a merger substantially lessens competition cannot be based solely on evidence of concentration or market share (S. 92(2)). Section 93(a) of the *Act* also directs our attention to the role of foreign competition, dynamic change and barriers to international trade. There have been several cases in which these types of factors have been particularly important in the decision made not to take action against a merger. I will summarize some of them very briefly:

The acquisition by Fletcher Challenge Limited of British Columbia Forest Products Limited was not challenged, in part, because of the availability of alternative, foreign sources of supply, including sources in the United States.[19]

Similarly, in the Amoco Canada/Dome Petroleum merger, the decision not to challenge was based in part on the constraining influence of international market forces on competition in relation to natural gas liquid products.[20]

Another example is Nova Corporation's acquisition of Polysar -- a case where we are monitoring the transaction for three years.[21] The Bureau's analysis determined that the markets for petrochemical derivative products were North American in scope and highly competitive. The Canada-U.S. Free Trade Agreement is expected to further enhance competition in relation to these products.

Efficiency Gains: Even when actual or potential foreign competition is not sufficient to prevent the conclusion that a merger has lessened competition substantially, S.96 of the *Act* provides that an assessment be made to determine if the merger should proceed on the basis of the magnitude of anticipated gains in efficiency that will be brought about. Section 96 provides that a merger shall not be blocked if it is likely to bring about gains in efficiency that will be greater than, and will offset the effects of any prevention or lessening of competition that will result, and if the gains would not otherwise likely be attained. In assessing efficiency gains, the *Act* requires that specific consideration be given to those gains that are likely to result in an increase in the value of Canadian exports or the substitution of domestic for imported products.

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[19] See the Director's *Annual Report* for 1986/87, p. 15.

[20] See the Director's *Annual Report* for 1987/88, p. 10.

[21] See *Canadian Competition Policy Record*, Vol. 9(2), 1988, pp. 9-10.

Cases in which efficiency gains played a role have included the acquisition by Fletcher Challenge of B.C. Forest Products Limited; the acquisition of Fruehauf Canada Inc. by the Trailmobile Group of Companies Ltd.;[22] the acquisition by Dofasco Inc. of the Algoma Steel Corporation;[23] and the recent acquisition by Consumers Packaging of Domglas[24] where anticipated efficiency gains were confirmed by an independent expert to be in the order of $53.9 million a year. Those gains should permit the parties to better meet foreign competition both in Canada and in the U.S.A.

Molson-Carling: The potential effects of foreign competition and the anticipated reduction of barriers to trade were important considerations in the decision in July 1989 not to challenge the Molson/Carling merger.[25] The beer industry is undergoing dynamic changes in many areas of Canada. The parties have informed my Office that they intend to provide access to the Molson distribution system in Quebec under certain circumstances. We will be monitoring these developments during the three-year period provided under the *Act* with particular attention being paid to the beer markets in Quebec and Alberta. The parties also expect to achieve considerable efficiency gains as a result of the merger which will assist their competitive position internationally.

In summary, I think the above cases illustrate that the *Competition Act* is designed and able to strike the right balance for Canada -- preserving domestic competition while ensuring Canada remains realistically attuned to the international marketplace.

3.2 Other Cases

While merger cases have been prominent and have attracted widespread media coverage, the impact of the new *Act* has been equally profound in other areas. I will briefly summarize some case examples:

Law Associations: In January 1988, the Supreme Court of Ontario issued an order of prohibition under the *Competition Act* against the two law associations of the Ontario counties of Kent and Waterloo and various executive officers of the two associations.[26] The conduct at issue involved attempts to achieve and enforce agreements on the legal fees members charged the public for residential real estate legal services. Inquiries had been initiated earlier under the conspiracy provisions of the *Act* (S.45). With the co-operation of the two associations, orders were agreed to for presentation to the Court by counsel for the Attorney General of Canada. The strong terms of the orders provided an effective remedy on an immediate basis without the uncertainty and time delay associated with extensive litigation. Actions by the Law Society of Upper Canada to deter similar conduct elsewhere in Ontario will increase the effectiveness of these orders. This case is unique in that it marks the first time that lawyers in Canada have been made subject to orders of prohibition under the competition legislation.

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[22] See *Canadian Competition Policy Record*, Vol. 9(1), 1988, pp. 5-6; Vol. 9(3), 1988, pp. 7-8; Vol. 10(1), 1989, p. 4.

[23] See *Canadian Competition Policy Record*, Vol. 9(4), 1988, pp. 11-12.

[24] See *Canadian Competition Policy Record*, Vol. 10(2), 1989, pp. 11-12.

[25] See *Canadian Competition Policy Record*, Vol. 10(3), 1989, pp. 2-3.

[26] See *Canadian Competition Policy Record*, Vol. 9(1), 1988, pp. 7-9.

Real Estate Industry: In December 1988, the Bureau's compliance-oriented approach to case resolution led to the issuance of a comprehensive order of prohibition by the Federal Court of Canada affecting the real estate industry across Canada.[27] Consumers and industry members had alleged that impediments to competition existed with respect to commissions, services or practices of nine real estate boards in five provinces. After very extensive negotiations, all parties were able to agree to a resolution through the consent prohibition order procedure. That order not only addressed competition concerns about the activities of the nine boards in question, but also, through the Canadian Real Estate Association, applied indirectly to the remaining 105 member boards across Canada. This case is an important example of the compliance-oriented approach generating effective, certain and immediate protection of competition in a manner that is also considerably less costly than contested litigation.

Chrysler: Also in December 1988, the first application under provisions of the *Competition Act* relating to refusal to supply was filed before the Competition Tribunal.[28] The application which was heard last July requests the Tribunal to order Chrysler Canada Ltd. to supply Chrysler automotive parts to a Montréal firm for export purposes.[29]

NutraSweet: Particularly noteworthy under the reviewable practices provisions of the *Act* is the application to the Tribunal relating to NutraSweet's activities in the Canadian aspartame market.[30] An inquiry was commenced in October 1988, and the application, which is currently before the Tribunal, seeks a remedial order under the abuse of dominance provisions. This represents the first Tribunal application under these provisions which were introduced in the 1986 amendments.[31]

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[27] See *Canadian Competition Policy Record*, Vol. 9(4), 1988, pp. 4-8.

[28] See *Canadian Competition Policy Record*, Vol. 9(4), 1988, pp. 8-9.

[29] On October 13, 1989 the Tribunal issued its decision in this matter finding that all elements of section 75 of the Act had been proven. An order was issued requiring Chrysler Canada Ltd. to accept Richard Brunet as a customer on trade terms usual and customary to their relationship. The decision also contains important and precedential discussion by the Tribunal regarding the concepts of product and market, the meaning of "substantially affected" and the other elements of section 75 of the Act. See *Canadian Competition Policy Record*, Vol. 10(4), 1989, pp. 4-9.

[30] See *Canadian Competition Policy Record*, Vol. 10(2), 1989, pp. 4-8; Vol. 10(3), 1989, pp. 7-8; Vol. 10(4), 1989, pp. 10-12.

The abuse of dominance provisions in the *Competition Act* may be available in other instances to complement the merger provisions. During or even beyond the three-year merger monitoring period, if it becomes evident that the new, merged entity is engaging in anticompetitive behaviour, these provisions can be invoked to obtain an appropriate remedy, including stopping the practice in question. Indeed, Parliament has specifically provided in two sections of the *Act* that the Director cannot bring an application under both the abuse of dominance and merger provisions on the basis of substantially the same facts, which reflects the dual remedies available in some instances.

Bid-rigging: Other precedents have been established under the criminal sections of the *Act*. Of significance is the conviction, in June 1988, under the bid-rigging provisions of the *Act*, of four companies in the business forms industry.[32] The conduct in question concerned tendering on provincial government supply contracts. The Saskatchewan Court of Queen's Bench levied fines totalling $1.6 million (including a $40,000 fine for a price maintenance offence) -- the largest total fine ever imposed under any section of either the *Competition Act* or its predecessor, the *Combines Investigation Act*. The individual fines assessed also were the largest ever levied under the bid-rigging provision.[33] Two of the firms convicted in Saskatchewan, Moore Corporation Limited and R.L. Crain Inc. had been convicted the previous day in Nova Scotia for similar bid-rigging on government contracts and fined $200,000 each. Orders of prohibition were also imposed by the two Courts against the companies involved and their officers and directors.

Ottawa Hotels: In a conspiracy case in 1987, major hotels in the Ottawa-Hull area were fined a total of $420,000 for their concerted activities in relation to the fixing of hotel room rates to government employees. In addition, the six hotels in question were made subject to an order of prohibition.[34]

Soft Drink Bottlers: More recently, the soft drink bottlers in Manitoba, including Coca-Cola Ltd., were fined a total of $230,000 after pleading guilty to price fixing charges.[35]

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[31] Eds. note: This case was decided in favour of the Director: (1990) 32 C.P.R. (3d) 1 - see Thompson (1991).

[32] See *Canadian Competition Policy Record*, Vol. 9(2), 1988, pp. 1-3.

[33] Eds. note: Subsequently, in December 1990 three flour millers were each fined $1 million after pleading guilty to bid-rigging charges. See *Globe and Mail*, December 8, 1990, pp. A1, A5. Recall, however, that in 1985 Simpson-Sears Ltd. was fined $1 million for misleading advertising [1985] C.C.I. 11437 (Ont. Co. Ct.).

[34] See the Director's *Annual Report* for 1987/88, p. 16 and *Canadian Competition Policy Record*, Vol. 8(2), 1987, pp. 5-7.

[35] See the Director's *Annual Report* for 1988/89, p. 23.

Epson: In December 1987, Epson (Canada) Limited pleaded guilty to 10 counts of price maintenance, or vertical price fixing, and was fined $20,000 on each count for a total of $200,000 by the Ontario District Court.[36] This sentence, the highest aggregate ever for price maintenance, is currently under appeal.

Toshiba: In February 1989, Toshiba Canada Limited pleaded guilty to two counts under the price maintenance provision and was fined a total of $65,000; in addition it was made subject to an order prohibiting the continuation or repetition of the offence.[37]

Shell Canada: In March 1989, Shell Canada was fined $100,000 on one count following a conviction for price maintenance in the supply of gasoline in the City of Winnipeg.[38] As the Court said in handing down the decision, "a contravention of the *Competition Act* is serious, and when it has to do with a commodity such as gasoline, affecting almost every citizen, it is even more so." Upon appeal, the fine was increased to $200,000.[39] The fine in this case doubled the previous highest per count fine imposed in a price maintenance case.

Commodore: In January 1989 Commodore Business Machines was convicted of four offences under the *Act* and fined $95,000.[40] The offences included discriminating between competing purchasers in the offering of quantity discounts and co-operative advertising support for which Commodore was fined $25,000 -- the highest ever imposed by a Canadian court for this offence.

Misleading Advertising: There have been a number of major cases relating to misleading advertising and deceptive marketing practices. Simpsons Ltd. was convicted of misleading representations concerning a promotional contest and fined $100,000. A number of companies and individuals including certain entertainment figures were convicted of misleading weight loss representations in Quebec and fined a total of $75,000. Also, an inquiry was commenced into the activities of the Principal Group of Companies which, following the conclusion of the Code Inquiry in Alberta into the collapse of the Group, resulted in charges being laid in July 1989 against a number of persons for misleading representations.[41]

Other activities in the misleading advertising area involved an increased use of alternative case resolution techniques (see Martin, 1991). Several noteworthy prohibition orders on consent have been issued in a variety of cases, including the following: In May 1987, an order was issued against Sears Canada Inc. concerning representations without adequate and proper testing of the all-weather traction capabilities of their tires. In January 1989, an order was issued against Cummins Diesel of Canada Limited for comparative performance claims made relating to the durability of their diesel engine parts, and in March 1989, an order was issued against International Exteriors Ltd. for claims relating to the durability and energy saving attributes of their metal roofing product. In September 1989, Sanyo T.V. was the subject of an order relating to the representation of the place of manufacture of their television sets.

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[36] See *Canadian Competition Policy Record*, Vol. 9(1), 1988, pp. 16-17.

[37] See the Director's *Annual Report* for 1988/89, p. 24.

[38] See *Canadian Competition Policy Record*, Vol. 10(1), 1989, p. 7.

[39] See *Canadian Competition Policy Record*, Vol. 11(1), 1990, pp. 2-3.

[40] See *Canadian Competition Policy Record*, Vol. 10(1), 1989, p. 4.

[41] See *Canadian Competition Policy Record*, Vol. 10(3), 1989, pp. 9-10.

A more selective enforcement approach has also proved successful in this area. While the number of convictions for misleading advertising has shown a small decline, concentration on cases of more serious detriment to consumers has resulted in a significant increase in total fines levied. In fact, this may also reflect a growing willingness on the part of the courts to see to it that anticompetitive behaviour simply will not be tolerated. In the past three years, average fines have risen to more than $13,000 -- the highest level in history and well above the average fine of slightly more than $6,000 in 1985/86.

Other Cases: There are also a number of other criminal cases presently before the courts, including charges of conspiracy and price maintenance. And there are a number of significant major inquiries currently underway especially in the areas of conspiracy, bid-rigging and reviewable matters.

The above cases are examples of our commitment to achieve strategic enforcement of the *Act* in areas of more significant importance to the economy and consumers. We have been making every effort to allocate our resources in a fashion designed to bring about as effective results as possible in fulfilment of the *Act*'s objectives.

3.3 International Aspects of Protecting Competition

In another aspect of our work, over the past three years we have been increasingly involved in the international aspects of protecting competition. When two Canadian automotive companies went to the Canadian Import Tribunal alleging that Hyundai Motor Company of Korea was dumping cars in Canada, a formal intervention was launched by my Office.[42] We stressed to the Tribunal the importance of encouraging competition in Canada's automobile industry. We argued that Hyundai had in fact been a positive influence on competition to the benefit of Canadian consumers. The Tribunal's ultimate finding of "no injury" to a large extent reflected our position.

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[42] See *Canadian Competition Policy Record*, Vol. 8(4), 1987, pp. 38-42 and Vol. 9(1), 1988, pp. 34-35.

Our Economics and International Affairs Branch has been involved in an increasing number of notifications to and from antitrust agencies in several foreign countries. The bulk of these have involved our United States antitrust counterparts and have, to a large extent, related to merger matters. With increasingly global markets we can see more co-operation among national antitrust authorities to improve our analysis and review of competition matters.

The Bureau's participation in the work of the OECD's Committee on Competition Law and Policy continues to be very active. The Committee's work is of important interest to us in these days of internationalization of certain markets and parallel business practices and issues.

Many industrialized nations are now engaged in the process of updating their own antitrust law, and we find some of them have keen interest in the Canadian experience. The *Competition Act* is regarded by some in the international arena as a state-of-the-art instrument particularly in its treatment of merger review. In fact, in October 1989 the Canadian merger review experience was one of the keynote papers presented at an OECD symposium for developing countries (see Goldman, 1989e). And we have seen increased interest with other OECD antitrust counterparts in pursuing bilateral discussions, once again primarily related to the merger review process which is being actively tested in many countries.

3.4 Constitutional Validity[43]

This review would be incomplete without touching briefly on two decisions delivered on April 20, 1989 by the Supreme Court of Canada in the *City National Leasing* and *Rocois Construction* cases.[44] The Court upheld the *Combines Investigation Act* as valid federal legislation under the general trade and commerce power and in so doing upheld the private right of action provision enacted in 1976. The Court also noted that in numerous cases the *Act* had already been upheld under the federal criminal law power. These decisions confirm that our federal competition law is constitutionally positioned on very solid ground. These decisions have also opened the door to civil actions under the *Competition Act* for breach of the criminal provisions of the statute.

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[43] On April 6, 1990 the Quebec Superior Court held that three provisions of the 1986 *Competition Act* were unconstitutional in the *Sanimal/Couture* case. It ruled that the merger provisions violated the freedom of association guarantees in the Charter of Rights and Freedoms. Further, Mr. Justice Philippon ruled that because it contained lay members, the Competition Tribunal was unconstitutional because it violates charter guarantees of a fair and impartial hearing. See *Globe and Mail*, April 11, 1990, pp. A1-A2. On April 18 the Crown decided to appeal (*Globe and Mail*, April 19, 1990, p. B5). Further, in the *NutraSweet* case on which final argument was being heard when the Quebec decision was rendered, the respondent challenged the constitutionality of the Tribunal. The Tribunal decided to rule on the matter promptly (see *Globe and Mail*, April 27, 1990, pp. B1, B4). More generally, see *Canadian Competition Policy Record*, Vol. 8(2), 1987, pp. 10-11. The validity of the conspiracy provisions has also been challenged in two cases. See *Canadian Competition Policy Record*, Vol. 11(3), 1990, pp. 1-3, Facey and Stanbury (1991), and Wetston (1991).

[44] See *Canadian Competition Policy Record*, Vol. 9(2), 1988, pp. 7-9; Vol. 10(2), 1989, pp. 1-3.

3.5 Public Information

From the commencement of the *Act*, three years ago, we have given high priority to public information -- to getting word out to the public about the new legislation and about our approach to its administration. We treat this not as a peripheral activity but as an indispensable, central part of the process. Sound corporate management and business growth depend on a full understanding of all the factors that impinge on a business plan. Furthermore, business and the public in general need a full understanding of competition law in order to assess its implications intelligently and to participate effectively in the process.

For these reasons, we make every effort to put as much information on the public record as possible, while respecting the statutory requirements for confidentiality. Once again a balanced approach is required -- one that ensures that the public is well-informed but also ensures that the sensitivity of certain business plans is maintained. For example: when the PWA/Wardair decision was reached, we issued a news release with an eight-page backgrounder which related the decision to various provisions of the *Act*.[45] In examining that transaction, we focused on the failing firm factor and the backgrounder highlighted our approach to this issue. Earlier in the process, the public was kept fully informed about other developments -- for instance, about our insistence that Wardair first shop around for an alternative purchaser -- a search which proved ultimately to be unsuccessful.

In announcing our decision to permit the Molson/Carling merger to proceed subject to monitoring, we issued an extensive news release and a backgrounder, explaining in detail the examination and relevant conclusions.[46]

A transaction which has attracted particularly wide public interest is the Imperial Oil/Texaco merger. I announced at the outset that I would place any divestiture package that emerged before the Tribunal. On June 29, 1989, I filed an application before the Tribunal for a consent order. In addition to the lengthy documents filed, which are on the public record at the Tribunal, the Bureau issued a detailed news release, an 18-page background paper, and four accompanying schedules. The Bureau later filed a comprehensive competitive impact statement with the Tribunal which, of course, is also on the public record. Detailed affidavits of experts for the Director in this matter were also filed as have other written submissions. The Tribunal eventually required that the proposed Consent Order be modified.[47]

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[45] See *Canadian Competition Policy Record*, Vol. 10(2), 1989, pp. 8-9.

[46] See *Canadian Competition Policy Record*, Vol. 10(3), 1989, pp. 2-3.

Technical briefings were also provided to the media at the time of the announcement of the Imperial Oil and Molson decisions in order to explain the rationale for our position in these complex mergers.

Consultation: Consultation with the public has been an integral part of the development of our approach to the *Competition Act*. In 1987, we instituted the Director's Consultative Forum. These are informal roundtables on competition law in which representatives of various business sectors the legal profession and consumers groups get together periodically to exchange views and discuss issues as they emerge. Three were held by October 1989 on the merger review process, on the compliance approach generally, and on measures to more effectively enforce the *Act*. In the latter Forum in December 1988, the role of private and class actions was discussed, as was the extent to which more prosecutions should be commenced against individuals involved in serious criminal offences under the *Act*.

In addition to the more formal consultations, a number of smaller-scale consultation meetings were held with representatives of specific sectors and industry and other associations. A meeting was held in 1989 with representatives of the food manufacturing industry to discuss market dynamics and issues of concern to that particular sector. Discussions which had commenced at the first Consultative Forum were pursued in 1989 with various groups concerning the information that the Bureau can and should provide to the public on case decisions. It was generally acknowledged that we should continue to try to increase the information provided to the public on the resolution of particular cases especially in the merger area. This will assist the public to better understand the *Act* and its administration, and a better informed public will be able to participate more effectively in the process.

Information Bulletins: Generally, to assist in meeting our objective of providing more information to the business and legal communities and to inform business and the public generally, we initiated the publication of a series of information bulletins. The first of these, released in June 1988, dealt with the merger provisions of the *Act*. The second, released in December 1988, set out the considerations that may be taken into account in the review of applications for merger-related Advance Ruling Certificates. We also spent considerable time in consultations with the legal community on our draft bulletin on the Program of Compliance, which was released in June 1989.[48] Additional bulletins are planned to address the factors guiding the Bureau's application of selected merger-related provisions of the *Competition Act* and in relation to discriminatory pricing.[49]

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[47] See *Canadian Competition Policy Record*, Vol. 10(4), 1989, pp. 2-4 and Vol. 11(1), 1990, pp. 3-6.

[48] See *Canadian Competition Policy Record*, Vol. 10(3), 1989, p. 11; Director of Investigation and Research (1989).

On this matter of public information, as in so many others, we have a critical balance to strike. On the one hand there is the need -- in fact the requirement -- to protect commercially sensitive information such as business plans, under the confidentiality provisions of the *Act*. On the other hand there is the need -- so important in terms of trying to achieve increasingly smooth and effective administration of the law -- to keep business, the legal profession and, indeed the public at large, adequately informed about the resolution of specific cases and about our general approach. A number of steps we have taken recently to enhance the public information side of the merger review process.[50]

And we have used speeches to communicate -- not only with the immediate audience -- but through publication and distribution in many instances, with a larger audience beyond it. Our goal has been to ensure that accurate information and responses to questions are provided to various interested audiences and accordingly, a rather demanding speaking schedule has been maintained over the past three years.

Annual Report: Last but not least, there is the comprehensive Annual Report to the Minister, tabled before Parliament each year as a statutory requirement. The report for 1987/88 contained a new, more readable format, with an overview of the activities for the year, and a specific chapter on mergers.

4.0 CONCLUDING REMARKS

Competition, properly protected, is highly desirable and effective. It is a force that generates considerable savings and increased consumer disposable income. It keeps Canadian industries sharp and efficient -- characteristics which are of great importance in the increasingly global economy. It constrains the unilateral or collusive exercise of market power. It preserves a place for small businesses, provides opportunities for new ones, and rewards innovation. When competition is protected, a propelling mechanism of the Canadian economy is protected.

Protecting competition requires the balancing of a number of goals and interests: balancing business and consumer interests; balancing the maintenance of competitive domestic markets with certain industries' desire to restructure in order to compete internationally; balancing the need for well-informed business and public communities, with the need to respect the sensitivity of certain business plans. The Bureau makes every attempt, in its activities, to recognize and strike the appropriate balance in what are often rather challenging and intricate situations.

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[49] Eds. note: The Director's *Merger Enforcement Guidelines* (Information Bulletin No. 5) were published in March 1991. A Discussion paper on price discrimination was published in July 1990. See Director of Investigation and Research (1991), (1990).

[50] See Goldman (1989b), (1989c), (1989d) and *Canadian Competition Policy Record*, Vol. 10(3), 1989, pp. 44-50.

To sum up: implementation of the *Competition Act* over the past three years has presented the Bureau with a new mandate and many new demands. We have handled a number of very large and complex mergers in addition to some rather significant cases in the more traditional enforcement areas. People in the Bureau have been working very hard to ensure that competition in Canada remains healthy and in step with an environment of increased international competitiveness. In my view, the diligence and professionalism displayed by so many members of the Bureau of Competition Policy in these challenging circumstances deserves the recognition of Canadians in all walks of life.[51]

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[51] Eds. note: Mr. Goldman's views after he resigned as Director can be found in Goldman (1990a) (1990b) (1990c) and in Goldman and Bodrug (1990).

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Chapter 25

INDEPENDENCE WITHOUT ACCOUNTABILITY WON'T LAST

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1.0 1889 TO 1909

Any celebration of the centenary of competition law in Canada has to be muted. No government in Canada has ever been accused of zeal in the implementation of an effective policy on competition. The pattern was set early. In the period from 1889 to 1900 there was only one prosecution - and it was unsuccessful (Gorecki and Stanbury, 1991).

The 1889 legislation was based on a report of a Select Committee of the House of Commons. For purposes of its report, the Committee had examined alleged conspiracies in twelve areas of business that included fire insurance, oatmeal milling, binder twine, stoves, coal, egg dealers, groceries, and sugar. The legislation was concerned only with combination in restraint of trade (see Baggaley, 1991).

The administration of the 1889 legislation was the responsibility of the provincial Attorneys General. In 1891, the disillusioned Chairman of the Select Committee, N. Clarke Wallace commented: "I think we have some reason to find fault with the Attorneys General of the various provinces for not having seen fit to enforce the law as it stands against those who are breaking it" (quoted in Ball, 1934, p. 11). In the ensuing century, the provincial Attorneys General have not been much more enthusiastic.

Perhaps however, the provincial Attorneys General were not more at fault in 1889 than the Parliament of Canada. The law of 1889 required the Crown to prove that the accused conspired, unlawfully to unduly prevent or lessen competition. Such drafting overkill in the burden imposed on the Crown would have an echo almost a hundred years later when the

Competition Act was introduced. Extensive business opposition to Mr. Wallace's original private member's bill resulted in the measure being referred to the Committee on Banking and Commerce, and that amendments made by both the House and the Senate resulted in a greatly weakened version of the original bill (Baggaley, 1991).

The word "unlawfully" was removed from the legislation in 1900. In its improved wording the section provided the basis for six prosecutions resulting in convictions. In addition, the courts found agreements brought before them in a number of civil suits to be contrary to the section and therefore illegal, and refused the parties to the agreements any rights under them (MacQuarrie 1952, p. 9; Gorecki and Stanbury, 1991).

According to the MacQuarrie Committee (1952) experience showed increasingly in combines cases, that the problem of securing evidence was a peculiarly difficult one. In one instance in this period, it was found necessary to resort to the appointment of a Parliamentary Committee to assemble the facts. The Committee noted that this was a task normally beyond the resources of private individuals, or the ordinary machinery of criminal investigation.

In 1909, E.C. Drury, then a high official of the Dominion Grange and Farmers' Alliance and later Premier of Ontario, led a deputation to Ottawa to ask that the Government appoint a special officer to investigate monopolies, and that the tariff be reduced on such articles as were found to be monopolized. This may have been the first strong plea for someone to perform the role of today's Director of Investigation and Research. Mr. Drury's bid however failed, although this was a period when a merger wave was under way that established oligopolies or monopolies in a number of Canadian industries including cement, steel, and flour (Bladen, 1932, p. 7).

2.0 1910-1952

The new legislation in 1910, the first *Combines Investigation Act*, did provide means by which citizens could initiate the investigation process. A version of this provision remains today. Any six citizens could apply to a judge for an order directing that an investigation into an alleged combine be held. If, after a hearing, the judge found the situation to warrant an inquiry, he could issue an order to that effect. The Minister of Labour was then to appoint a board of three commissioners to conduct a full inquiry (see Gorecki and Stanbury, 1991). In fact, the machinery of this first *Combines Investigation Act* was fully used only once -- in the United Shoe Machinery case -- before the country was engulfed in the more pressing concerns of Word War I. Ball (1934, p. 139) concluded that the United Shoe Machinery case was "long, expensive, and resulted in only a paper victory for the applicants."

According to the MacQuarrie Committee (1952, p.11) the 1910 legislation revealed two prime weaknesses. The first was that private citizens were reluctant to shoulder the considerable responsibility of initiating investigations, because of the expense and publicity. They had to convince a judge that a *prima facie* case existed, and if successful, to make representations to the board that was then established. The second weakness was that there was no individual or body to provide continuity in the administration of the legislation. Each board was to be constituted on an *ad hoc* basis. Upon completion of the investigation and submission of a report, the board ceased to function. There was consequently no machinery to determine whether any recommendations of the report were being carried out (see Gorecki and Stanbury, 1991).

The inflation and allegations of profiteering in World War I precipitated demands for new legislation. In 1919 the *Combines Investigation Act* was replaced by two statutes - the *Combines and Fair Prices Act* and the *Board of Commerce Act*. The latter set up a three person board to supervise the administration and enforcement of the legislation. The Board could initiate an inquiry of its own accord or at the request of a citizen. The Board could issue an order against a combine to cease and desist from any practices that were contrary to the *Act*. The penalties for breaking the Board's rulings were substantial. However, in 1921, the Judicial Committee of the Privy Council found the 1919 legislation to be *ultra vires* of the Dominion Parliament (Gorecki and Stanbury, 1991).

Under the *Combines Investigation Act* of 1923, which survived substantially unaltered until 1952, inquiries could be conducted by the Registrar or by a specially appointed commissioner. The legislation conferred the power to obtain documents and to compel the attendance of witnesses on whoever carried out the inquiry. The final report usually contained an opinion as to the guilt or innocence of those whose conduct was being inquired into. All reports written by a special commissioner were to be published 15 days after they had been transmitted to the Minister. Curiously however, the Minister had complete discretion in deciding whether a report written by the Registrar should be published (Gorecki and Stanbury, 1991).

Under the 1923 *Act*, when the Minister transmitted a report to the appropriate Attorney General for possible prosecution, the matter did not necessarily end if the provincial Attorney General decided to let the matter drop. Ball (1934, p. 66) makes an instructive comment on this point and on the dedication of the provincial authorities. If the provincial Attorney General decided not to take any action, then

> ... any citizen over twenty-one years of age may lay an information against the combine before the Solicitor General (of Canada); and if the Governor in Council deems the case sufficiently in the public interest the Minister of Justice may appoint counsel to prosecute the offender on behalf of the Dominion. This specific statement is important because it had been frequently alleged that many of the enforcement bodies had not been overly anxious to prosecute. Now, even if there

> is extreme reluctance on the part of the Attorney General, the complaint of any citizen may initiate the machinery for prosecution.

In 1935 the *Dominion Trade and Industry Commission Act* was passed. Among other things the Commission rather than the Registrar was to administer the *Combines Investigation Act*. Part of the new *Act* that permitted the Commission to authorize industrial agreements to prevent "wasteful" or "demoralizing" competition was declared *ultra vires* in 1937.

In the same year the *Combines Investigation Act* was amended to put the administration of the Act back into the hands of a permanent Commissioner, with the title changed from Registrar. The Commissioner's power to initiate investigations on his own volition was deleted however (and was not restored until 1946). The *Combines Investigation Act* was also amended in 1937 to permit the Attorney General of Canada to bring cases on his own under the *Combines Act* or the *Criminal Code* (Gorecki and Stanbury, 1991, Appendix A).

Skeoch (1966) provides a tabulation of the 41 reports made to the Minister, over a period of 30 years up to 1953, under the authority of the 1923 Act and subsequent amendments. It appears that all reports by a Special Commissioner were published in full. The statute required publication within 15 days of transmission of the report to the Minister, unless the Commissioner was of the opinion that the public interest would be better served by withholding publication, in which case the Minister had full discretion.

In contrast, between 1923 and 1937, the Act was silent about whether reports of the Registrar should be published. Nevertheless until 1929, all reports of the Registrar were in fact published (Skeoch, 1966). Subsequently, an unsympathetic Government declined to publish reports of five inquiries by the Registrar which presented evidence of price-fixing. These involved the flour-milling industry (December 30, 1931); radio tubes and sets (July 10 and October 24, 1931, and June 7, 1932); fruit (March 18, 1932); rubber footwear (Mar. 29, 1934); and gasoline in Ontario (May 29, 1934). In addition, in the case of the Registrar's report on the distribution of British anthracite coal, the report was transmitted to the Minister on April 21, 1933, but was not published until almost three years later on March 10, 1936 when the Government had changed. This sorry record on the part of the Cabinet during the depression years is no longer likely to be excused as it once was, by the argument that downward price flexibility in a recession is a bad thing.

What lessons are to be drawn about the role of the Director of Investigation and Research from the first fifty years of antitrust legislation in Canada? Two stand out. First, political support for an effective policy is a sometime thing. There were long stretches, the two decades 1889 to 1900 and 1910 to 1920 for example, when virtually nothing happened in the enforcement of the legislation. The Government's interest waxes and wanes, depending on the state of the economy, the party in power, and other variables.

Second, it is essential to have a permanent office of some kind with the expertise and resources to monitor the market place, to conduct the special kinds of investigations required, and to provide continuity. Otherwise the chances are the law will become a dead letter. The point is that only an independent director can be relied upon for sustained enforcement.

3.0 MIXED SIGNALS

In the post World War II period, Canadian governments have continued to give mixed signals to the public and to the business community. The *Interim Report* of the Economic Council (1969, p. 56) provides a succinct account of the McGregor controversy.

> In December 1948, the Combines Commissioner, Mr. F.A. McGregor, forwarded to the Minister of Justice the results of his inquiry into the flour milling industry. In it, Mr. McGregor concluded that the leading milling companies had maintained price-fixing agreements since at least 1936, that these agreements were maintained in force during the war, and that the firms colluded in bidding for government contracts. Despite the requirements of the Act, the Report was still unpublished in October 1949. Mr. McGregor resigned on October 29, calling in his letter of resignation, for 'an even stronger statute than the Act in its present form, and a clear statement of government policy with respect to its enforcement.' Tabled in the House of Commons on November 7, the flour-milling report raised, among other things, the issue of an industry being condemned for carrying out policies sanctioned by the Wartime Prices and Trade Board during the war and tacitly allowed by the government in the subsequent period of decontrol.

Why did McGregor resign in 1949 over the flour-milling report, though he had not done so over the non-publication of a number of reports in the early 1930s? A major difference of course was that by 1949, the statute required the Minister to publish the report within 15 days, and he was breaking the law by not doing so.

Perhaps of equal significance, there was a constituency in 1949 that did not exist in the earlier period, which could be counted upon to support the independence of the Commissioner and to react to his resignation. In the event, the intensity of that reaction guaranteed the independence of McGregor's tough-minded successors for many of the years that followed. However it is highly doubtful that any similar constituency exists today.

One reason that a constituency existed in 1949 is that McGregor then had a long track record. He had been the personal secretary of Mackenzie King, thus not likely to be unsympathetic to the Government of the day. He had been Registrar and the Commissioner under the *Combines Investigation Act* for most of the years between 1925 and 1949, and he had been Enforcement Administrator under the Wartime Prices and Trade Board (see Gorecki and Stanbury, 1991).

Part of the international planning for a brave new world after the War, which eventually produced the United Nations, the IMF, the World Bank, and the GATT, involved doing something about international cartels. In 1944, McGregor was asked by the Government to conduct a study of the subject. His report *Canada and International Cartels*, published in October 1945, among other things provided examples of cartel arrangements that affected Canadian imports of potash, nitrogen, phosphorus, flat glass, sulphur, dyestuffs, titanium pigments, etc.; examples of cartel arrangements that restricted Canadian manufacturers to their home market, in the supply of soda ash, electric lamps, radio tubes and sets, matches, etc.; and examples of cartel arrangements that involved Canadian exporters of copper, lead, zinc, nickel, steel, aluminum, acetic acid, radium and newsprint. People were appalled by the possibility that some of these cartel arrangements had promoted the growth of the Nazi war machine. Later published reports of inquiries into dental supplies, optical goods, flat glass and matches continued McGregor's accountability to the court of public opinion.

Unlike the early 1930s, after World War II, McGregor no longer worked virtually alone. The Combines Branch of the Department of Justice had a young and enthusiastic staff, which, if it was a nuisance in questioning McGregor about the non-publication of the flour-milling report, nevertheless, could be counted upon to push for an effective policy on enforcement in the event of McGregor's resignation.

In addition, the CCF (now the New Democratic Party), led by one of Canada's greatest parliamentarians, M. J. Coldwell, was a vigorous supporter of a strong law on competition. This probably reflected the populist roots of the party. As the trade unions became more influential, the party's support for a strong law became more ambivalent.

The pro-competition constituency was further strengthened by support from some of the media, particularly the *Winnipeg Free Press*. The *Free Press* at first supported the Government against McGregor, but quickly changed its position in a series of vigorous editorials that were later collected and reprinted in pamphlet form (Winnipeg Free Press, 1949).

Faced with a barrage of criticism for its handling of the flour-milling report, the Government appointed the MacQuarrie Committee in 1950 to study the legislation in Canada and abroad. The chief recommendations of the MacQuarrie Committee (1952), apart from those involving the prohibition of resale price maintenance, related to administration.

4.0 INDEPENDENCE OF THE DIRECTOR

The MacQuarrie Committee proposed that there be a separation of function between investigation and research on the one hand, and appraisal and report on the other. The business community had long and bitterly complained that the existing Commissioner was placed in the position of both prosecutor and judge. This was of course hyperbole since the Commissioner did not determine any rights. His only function was to assemble and report upon the evidence and the effect on competition; the matter of prosecution was always a matter for decision by the Attorney General alone. What should really disturb us is the fact that no similar groundswell of protest from the business community has developed over the incomparably greater power of the Director of Investigation and Research to affect rights under the *Competition Act*.

In line with the MacQuarrie Committee's recommendations, the amendments to the *Combines Investigation Act* introduced in 1952 provided for a Director of Investigation and Research (DIR) and for a Restrictive Trade Practices Commission (RTPC). Significantly, from the perspective of this review, the Committee recommended that the new RTPC report to the Minister, that the requirement about publication of the report be retained for its deterrent effect, and that the scope of the report be widened.

Developments in Canada in subsequent years have strongly reinforced the case for assuring the continued independence of the DIR. In the first place, today's economy is marked by the pervasiveness of government intervention. On the one hand, this places enormous demands on the time of Ministers and reduces their attention span. On the other hand, the pervasiveness of government means that Ministers are accustomed to intervening, and given the opportunity, they may be tempted to ignore the legislated tests of the *Competition Act*, and to substitute the test of political advantage.

In the second place, any such tendency can only be reinforced by the television-promoted drift in Canada towards the politics of image rather than the politics of substance. Election campaigns now rely heavily on photo opportunities and a few minutes exposure on the nightly television news. Competition policy issues that often involve the assembly of large amounts of data and the weighing of conflicting theories about the use of the data, have no place in such television coverage.

In the third place, the public service cannot be relied upon to the extent it was in the past, to guide Ministers with disinterested advice. The public service has become increasingly politicized.

These three developments -- the intrusiveness of government, the growth of image politics, the polticization of the public service - have made our political system increasingly vulnerable to the growth of lobbying, particularly by business lobbies (see Stanbury, 1977). Business has easy access to funds for political contributions (Stanbury, 1986a, Ch. 10). Business alone can promise new plants and new jobs, or almost blackmail politicians with the threat of plant closure and loss of jobs. Business can call the tune when the press is highly concentrated by threatening to withdraw advertising.

We are no longer surprised at the way business has shaped tax policy (see McQuaig, 1987) to its advantage, particularly income tax policy, or regional development policy and its attendant subsidies, or national defense policy and its attendant offsets, or environmental policy, or policy on resource conservation. Who can doubt that the Business Council on National Issues was the most influential lobby in drafting the *Competition Act*,[1] or the Canadian bargaining position on free trade?

All this makes a strong case for the continued independence of the DIR. Yet in the end the case depends on the public perception, as it did at the time of McGregor's resignation, that the DIR can be relied upon to discharge his responsibilities under the *Act*, even if this makes life difficult for the Government. The public can develop this perception only if the DIR is openly accountable for what he does. He cannot be held to account if most of his decisions reflect negotiated settlements arrived at behind closed doors. While such settlements are eventually disclosed in summary form, there is little hard information on which outsiders can judge the appropriateness of the arrangement (see Stanbury, 1991).

What makes this situation doubly serious is that in two of the most important areas of the law, *viz.* merger and abuse of a dominant position, the way in which the tests in the statute will eventually be applied by the Competition Tribunal and the courts is quite unpredictable.

This, it is necessary to emphasize, is entirely different from the one area - refusal to supply -- where negotiated settlements have been used with some frequency in the past. Gorecki and Stanbury (1991) note that "Reference to the Annual Reports of the Registrar however, does permit us to make a number of qualitative statements. The use of private negotiations typically seems to have taken place when a firm refused to supply a customer ..." In the case of refusal to supply, the law is fairly clear, and it is easy for all concerned to see whether a negotiated settlement has produced a satisfactory solution.

In the case of a merger, nothing is clear.[2] The greatest uncertainty in the merger law is created by section 96(1).

> The Tribunal shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order was made.

The problem is not only that both effects are difficult to measure, and that they are even more difficult to forecast, but what is worse, gains in efficiency and lessening of competition can't be measured on the same scale. The provision assumes that the DIR will be able to assemble large amounts of engineering or accounting data on efficiency and large amounts of economic data on competition, that he will be able to predict changes in all of this as a result of the merger, and that the Tribunal will be able to weigh the two and find that the gains in the first will offset losses in the second. But even if you were to succeed in quantifying in some way the increase in efficiency and the decrease in competition, you still wouldn't know how many units of one offset how many units of the other.

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[1] For a critique of their earlier efforts to shape competition policy, see Stanbury (1981).

[2] For an effort to explain how the merger provisions are to be enforced, see Director of Investigation and Research (1991). The previous Director's approach is described in Goldman (1987) (1988a) (1988b) (1989a) (1989b) (1990a) (1990b).

Even if you somehow finesse this problem you still must confront the fact that competition is a dynamic process. Without it, efficiency and innovation are likely to decline. One assumes that in the U.S.S.R., the state monopolies were positioned long ago to take advantage of all possible economies of scale and of scope, but the results are plain. Accordingly, it can be argued that one can never predict that serious injury to competition will be offset by expected gains in efficiency, because such gains are likely to be transitory if much of the stimulus of competition is removed.

The consequence is that any judgment by the DIR or even the Tribunal is bound at this stage to be subjective and therefore unpredictable. A comment of the MacQuarrie Committee (1952, p. 38) is pertinent:

> The courts have been at pains to explain, not only that they are not required by the legislation to find specific detriment but that they would not be apt instruments to make such a finding. They lack the machinery and it is not their proper role to enter upon the very wide inquiry which would be needed if economic performance instead of the lessening of competition were the test. When efficiency has to be judged, administrative machinery such as public utility boards is the means which must be created for this purpose.

Likewise the Economic Council's *Interim Report on Competition Policy* (1969, pp. 25, 26) states:

> The general notion of replacing the complex legal trappings of competition policy by something more in the nature of an expert review panel that would simply address itself to the question of whether an industry's or firm's performance was generally progressive and efficient is an eternally seductive one. The great difficulties involved only become apparent when one gets down to the details of turning it into practical public policy: 'What will be lacking is any basis for deciding whether the firm's performance was good or bad in light of its opportunities'... There is also the problem that good performance in the past gives no necessary assurance of similar performance in the future. To be really meaningful, enforcement of the policy would have to be continuous with a large bureaucracy to second-guess all important managerial decisions.

These sources are cited, not to cast doubt on the wisdom of the public policy embodied in the law, though they do that, but because they demonstrate the high level of uncertainty that is inescapably associated with the trade-off which the law envisages.

Without some more or less arbitrary formula to be used in the application of section 96 (1) which the Tribunal and ultimately the Appeal Courts must provide, it will be open to everyone in a particular case to place whatever weight he prefers on efficiency on the one hand versus competition on the other. Thus, in the words of the American economist Ben Lewis, in another context, we all wrap our arms tightly around our prejudices, and jump.

5.0 ABUSE OF DOMINANT POSITION

The operational meaning of the provisions in sections 78 and 79 on abuse of dominant position is also fraught with uncertainty.[3] Bill C-91 was introduced in 1985 after a lengthy period of consultation by Consumer & Corporate Affairs mainly with business groups. As first introduced, the abuse of dominant position provisions were arguably unenforceable.

To illustrate the difficulty, consider the burden of proof faced by the DIR in making a case before the Tribunal that involved "fighting-brands". This is one of the anticompetitive acts that are listed in section 78 by way of example. The DIR would have had to clear six evidentiary hurdles and would have had to prove:

(1) that a company introduced certain brands selectively, in a geographic sense, and on a temporary basis;
(2) that this was done for the purpose of disciplining or eliminating a competitor;
(3) that the company had substantial or complete control of the class or species of business;
(4) that the company had been engaging in a practice of anticompetitive acts;
(5) that the object of the practice was to lessen competition; and
(6) that the likely effect of the practice was to prevent or lessen competition substantially.

Such drafting overkill in the burden imposed on the Crown is probably unmatched since the original legislation of 1889.

Fortunately one hurdle, the fifth, was eliminated before the Bill became law (Stanbury, 1986b). Nevertheless, there remains considerable doubt about the enforceability of these provisions.[4] The greatest uncertainty arises in proving that the likely effect of the practice of anticompetitive acts is to prevent or lessen competition substantially (item 6). There is little jurisprudence to guide us. However, except for two circumstances, it is difficult to conceive of a situation where someone who had substantial or complete control of a market and who engaged in a practice of anticompetitive acts over a period of time, did not prevent or substantially lessen competition. This might conceivably occur if the amount of commerce affected was insignificant or if some minor dimension of competition was involved. Therefore in order to overcome the final hurdle (item 6) it should be necessary to prove only that the impact on competition is both quantitatively and qualitatively substantial. Needless to say, there is unlikely to be any consensus about this until some guidance is provided by the Tribunal or the courts.

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[3] See McDonald (1987); Anderson and Khosla (1987).

[4] It should be noted that the Director won the first abuse case concerning *NutraSweet Co.*, see Hunter (1990); (1990) 32 C.P.R. (3d) 1; Thompson (1991).

The absence of any consensus represents the heart of the problem. What are the implications of overwhelming reliance on negotiated settlements, when the tests in the statute are open to so much question?

6.0 NEGOTIATED SETTLEMENTS[5]

Considerable light is thrown on this question if one examines briefly four recent matters, *viz.* the airline, oil company and Palm Dairies mergers and the conspiracies in local law societies of Ontario. This requires consideration of what the public reaction must be to the available facts, and what account the DIR thus renders of how he is discharging his responsibilities.

6.1 Airlines

The following extracts are taken from the press release that confirmed the DIR's decision on April 14, 1989, not to challenge the proposed acquisition of Wardair Inc. by PWA (CAIL).

> Information obtained indicates that the acquisition of Wardair by PWA will result in the removal of an effective and vigorous competitor.
>
> A comparison of fares and schedules demonstrates that price competition was more vigorous in markets where Wardair was present than in markets where only AC and CAIL provide service.
>
> A number of other indications show that there will likely be less competition in the industry subsequent to the merger. The stock market reaction, which led to higher stock prices for both AC and PWAC suggests that investors expect increased profits from both rivals of Wardair. Moreover statements by officials of Wardair and PWAC indicate that capacity in the industry is expected to be reduced and the availability of discounted seats will be more restricted than in past years.
>
> While facilities are available and Transport Canada has a policy that encourages accommodating new entrants, the prime airport space is controlled by AC and CAIL.
>
> The second regulatory entry barrier is the restriction of foreign-ownership to a maximum of 25 percent voting interest. This makes it relatively unattractive for American carriers to consider equity interest in Canadian carriers.
>
> In addition to the 25 percent limit on foreign ownership, the Director recognized that there is little likelihood that foreign carriers can enter the domestic market.

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[5] For other critiques, see Maule and Ross (1989) and Stanbury (1991).

> Cabotage, or the operation of point-to-point scheduled services within Canada by foreign carriers is currently prohibited by federal law.

The DIR's decision "is largely based on the evidence that Wardair is a failing business and that there are no alternatives to the merger that would result in a more competitive environment." This won't satisfy those who believe that the prompt reduction or elimination of one or both barriers against competition from foreign airlines was an obvious solution.

But what is more serious from the standpoint of the DIR's accountability is that there is no reference to one option that was in principle open to him. He might have brought a case to the Tribunal many months before, based on abuse of shared dominance by Air Canada and PWA (CAIL) when they were buying up most of the regional and feeder airlines in the country; setting up Gemini - the computer reservation system created by the merger of Air Canada's Reservec and Canadian Airlines' Pegasus -- which the DIR actually brought before the Tribunal and then withdrew; and engaging in predatory pricing by charging lower prices in markets where Wardair was present than in markets where Air Canada and CAIL only faced each other. If such a case had been brought, it would no doubt have complicated the Government's plan to privatize Air Canada,[6] but it is unlikely that Wardair, a much leaner operation than the other two, would have become a failing firm.

The country was promised a more competitive air transport industry following deregulation. Instead we have ended up with an unregulated duopoly (see Oum et al., 1991). This situation remains a standing affront to the people of Canada. Government policy will have allowed the continuation of competitive fares to Europe, to the U.S.A. and across the Pacific, but within Canada will have encouraged monopoly pricing. Travel abroad will be cheap but travel within Canada will be expensive. This is a poor way to promote the unity of the country.

Ministers will have to answer for this state of affairs. On the one hand, Ministers may not be unhappy if they encouraged the DIR to allow the development of a monopoly in order to make Air Canada's shares more saleable. In such case however, the independence of the DIR will already have been compromised. On the other hand, if Ministers really wanted a more competitive airline industry, they will not be happy about the DIR's decision. Either way, this case raises questions about the DIR's independence in the long run.

6.2 Petroleum

The consent application to the Tribunal that is being made in the case of Imperial Oil's acquisition of Texaco, seems to indicate that if you are big enough in Canada, you don't have to worry much about the prohibition of a merger, only about the terms under which it will be allowed.

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[6] Air Canada was privatized through the sale of shares in two batches in September 1988 and July 1989.

According to information from the federal Petroleum Monitoring Agency, in 1984 the four majors - Imperial, Shell, Gulf, Texaco - plus Petro-Canada accounted for 77% of the volume of all refined petroleum products sold in Canada (RTPC, 1986, p. 208). Changes in the industry since 1960 had involved a reduction by half in the number of refiners (from 24 to 11) and by about one-third in the number of refineries (from 44 to 25) and included a reduction in refinery capacity of about 16% since 1979 (RTPC, 1986, p. 209). Concentration increased further in 1985 when Petro-Canada purchased Gulf's downstream assets west of Quebec, and Ultramar Canada, which was a big regional refiner in Quebec and Atlantic Canada, purchased Gulf's eastern Canadian marketing assets (RTPC, 1986 p. 242).

According to the Restrictive Trade Practices Commission, the unavoidably high concentration in petroleum refining, together with pervasive vertical integration and dual distribution, made it very important even in 1986, that all reasonable steps be taken to maximize the assurance of supply to unintegrated marketers. One avenue, the RTPC said, is to clarify the scope of the duty of domestic refiners to supply product to others. Nothing has been done about this recommendation. Secondly, said the RTPC, the import option becomes an extremely important competitive factor in areas of the country open to imports. These ways of assuring ready access to supplies are more important in Canada than in countries such as the U.S., the RTPC said, which by virtue of their larger markets, have more refiners, wholesalers and retailers and stronger general competitive pressures (RTPC, 1986, p.467).

The Canadian petroleum industry is characterized not only by high concentration, but also by a vast web of supply agreements. Refiners trade or exchange product with each other on a reciprocal basis, purchase from and sell product to each other without reciprocal conditions, occasionally process crude oil at one of their refineries for another refiner who lacks convenient refining capacity, and store product for each other (RTPC, 1986 p.224). According to the RTPC, Imperial Oil had an average of 142 different supply agreements in force in each of the years 1979 to 1981. Indeed Imperial had supply agreements of one form or another with each of the other Canadian refiners.

The RTPC concluded that refiners are likely to be the most cost-effective importers from abroad or from another region, and the most likely potential new entrants, and therefore the increased duration of, and volume covered by exchange agreements in recent years raised a competition policy concern (RTPC, 1986 p. 237).

The Commission described in some detail the most far-reaching product supply arrangement of all. This was entered into in 1983 by Texaco and Gulf and was to run for many years. The arrangement consisted of seven agreements, as follows:

(1) Gulf would process for Texaco at Edmonton.
(2) Gulf would supply product to Texaco out of Edmonton in exchange for product supplied by Texaco to Gulf out of Nanticoke in Ontario.
(3) Texaco would process for Gulf at Nanticoke.
(4) Gulf would process for Texaco at Montreal.
(5) Texaco would sell to Gulf out of Dartmouth and Gulf would sell to Texaco out of Montreal.
(6) Gulf would terminal for Texaco at Clarkson.
(7) Texaco would terminal for Gulf at Calgary.

In conjunction with entering into this new arrangement, Texaco closed its Edmonton refinery and Gulf discontinued gasoline production at its Clarkson refinery near Toronto (RTPC, 1986 p.238). When Petro-Canada purchased Gulf's downstream assets west of Quebec in 1985, it took over Gulf's supply arrangements with Texaco west of Quebec. Petro-Canada also took assignment of Gulf's obligation to process for Texaco in Montreal (RTPC, 1986 p. 242).

According to the RTPC, there were collateral terms in some of the inter-refinery supply agreements in evidence that were not necessary to the purpose of the agreements, that may have exclusionary effects in particular markets and that should be reviewed under the *Competition Act*. These involved exclusive dealing provisions covering additional supply, preferential rights to any surplus processing capacity, preferential treatment in times of supply shortage, and the excessive duration of long-term supply contracts (that sometimes exceeded the 8 or 10 year planning horizon for even a large refinery).

In the Commission's view, there is need for a process by which the good and bad effects of particular major long-term supply arrangements between or among refiners can be assessed and weighed against each other as is envisaged under the *Competition Act* for mergers and specialization agreements (RTPC, 1986, p. 250).

The Commission said it was concerned about the trend over the last decade towards greater centralization in the hands of refiners of the power to set pump prices. Supply arrangements under which refiners obtain partial or complete control over the retail prices of customers with whom they would otherwise compete at the retail level, the Commission said, tend to lessen competition. In the Commission's view support programs that relate the amount of support to particular retail prices, as was the case with all margin support programs referred to in the evidence, and that are widespread in the industry, are contrary to the public interest (RTPC, 1986 p. 465).

The Commission said that recent changes in wholesale pricing practices, referred to as "rack pricing" adversely affect competition insofar as they involve openly stated policies that confidential discounts will not be granted off published prices. The effect of public announcements by suppliers in a tight oligopoly to the effect that they will not be granting unpublished discounts off published or widely-known supply prices, can produce an effect very much like that of a horizontal agreement. It communicates past and current actual transaction prices to competitors of the supplier and to competing customers, and where the products are as homogeneous as petroleum products it presents a real risk to the intensity of price competition. Such is the case, said the Commission, with the emerging so-called "rack-pricing" policies of Imperial Oil and other refiners (RTPC, 1986 p. 466).

Given that the results of the most exhaustive inquiry ever undertaken into competition in the petroleum industry are a matter of recent public record, given that they underline the significance of high levels of concentration and the presence of anticompetitive practices in the industry, and given that the DIR, nevertheless, sought a negotiated settlement, rather than a prohibition of the acquisition of Texaco by Imperial Oil, one is entitled to ask if any prohibition will ever be sought at all in a case where a company is large and offers to negotiate.[7]

The potential that this decision holds for embarrassing Ministers some distance down the road may be considerable. In the past, when the world price of crude oil dropped substantially over a short period of time, prices of refined products in the U.S. were quick to follow. Not so in Canada. Prices of refined products here have been much more inflexible downwards. If this happens again, the explanation by Ministers should be interesting.

6.3 Palm Dairies

The Tribunal has no power to require that a matter be brought before it, but it has indicated in the Palm Dairies decision (November 27, 1986) that when a consent order is applied for, it will exercise its discretion as to whether the consent order reasonably meets the requirements of the *Act* and is appropriate in the circumstances.[8]

The proposed acquisition of Palm Dairies in 1986 by Fraser Valley Milk Producers Cooperative Association and. others, was the first matter brought before the Competition Tribunal. In that case the Tribunal refused to accept the consent arrangement worked out between the DIR and the parties. As a result, the transaction did not proceed.

On March 31, 1989, the DIR announced that he would not challenge the acquisition of Palm Dairies' facilities in British Columbia by Fraser Valley and Island Farm Dairies Cooperative Association.[9] Fraser Valley, a large cooperative operating throughout B.C. acquired all Palm Dairies facilities on the mainland. Island Farms acquired the Palm Dairies facilities on Vancouver Island where Island Farms is based.

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[7] See *Canadian Competition Policy Record*, Vol. 10(4), 1989, pp. 2-4; Vol. 11(1), 1990, pp. 3-6; Stanbury (1991).

[8] (1986) 12 C.P.R. (3d) 540. See also *Canadian Competition Policy Record*, Vol. 7(3), 1986, pp. 4-6; Vol. 7(4), 1986, pp. 1-4.

[9] See *Canadian Competition Policy Record*, Vol. 10(2), 1989, pp. 17-18.

The DIR indicated that though he was concerned about the effect of the acquisitions on competition, he decided not to challenge the acquisitions because the Palm Dairies business in B.C. was failing. He had received answers from Peter Pocklington, the owner of Palm Dairies, and from independent financial institutions to satisfy him that the B.C. operations of Palm were indeed failing, and that no alternative buyers were available to acquire the business.

There are two reasons to be concerned about the DIR's accountability in this case. The first reason is that on the first try, the Competition Tribunal refused to accept the consent arrangement that had been agreed to by the parties. Among other things, the Tribunal said "There is no evidence before the Tribunal that this complex arrangement, as opposed to a more simple, straightforward remedy such as allowing another (completely independent) purchaser to acquire Palm Dairies, is necessary to meet the objectives of the Act. Also, there is reason to doubt the effectiveness of the arrangement which it is sought to impose and consequently issuing the order could possibly lead to a substantial reduction in competition."[10] The DIR filed a notice of appeal which was subsequently withdrawn.[11] In conformity with the Tribunal's judgment, Unicorp - the owner of Palm Dairies subsequently found a different buyer for the whole company - Peter Pocklington.

The second reason to be concerned about the DIR's accountability in this case is that on the second try, he again agreed to a competition - limiting acquisition by Fraser Valley, but this time he gave the Tribunal no opportunity to have any influence over the outcome.

6.4 Ontario County Law Societies

The fourth case that invites questions about the Director's accountability involves two Ontario county law associations. In January 11, 1988, orders of prohibition were issued against the Kent County Law Association and the Waterloo Law Association and their respective executives and members.[12]

Both associations consented to the terms of the orders and the accompanying admissions. The admissions describe the various steps that each of the associations took in attempts to achieve and enforce agreements on the legal fees that members would charge the public for residential real estate legal services.

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[10] *Canadian Competition Policy Record*, Vol. 7(4), 1986, p. 2.

[11] *Canadian Competition Policy Record*, Vol. 8(1), 1987, p. 2.

[12] *Canadian Competition Policy Record*, Vol. 9(1), 1988, pp. 7-9.

In the case of the Waterloo Law Association the executive proposed a fee schedule and the sanctions that could be used against members to enforce it. At a 1985 meeting attended by the vast majority of lawyers providing residential real estate legal services in Waterloo, the fee schedule was ratified by a unanimous vote.

In the case of the Kent County Law Association, at a 1984 meeting attended by 80% of the Association's members, a fee schedule covering residential real estate matters was unanimously agreed to, each member was asked to sign an undertaking to adhere to the fee schedule, and an Association by-law made failure to agree to adhere a matter of unprofessional conduct.[13]

What makes this case remarkable is that the DIR merely sought a Prohibition Order without conviction in terms consented to by the parties, rather than recommending prosecution to the Attorney General. There have been dozens of successful prosecutions for price-fixing in the past (see the paper by Stanbury in Part 2 of this volume). There have been very few cases of price-fixing where only a prohibition order was sought. These few cases usually involved people who might have been excused for not knowing the law, such as gas station operators. But lawyers!

Amendment to the *Combines Investigation Act* extended the conspiracy provisions to the professions in 1975, a full ten years before the DIR's decision to seek only a prohibition order. The Law Society of Upper Canada made no attempt to argue that the Law Society Act authorizes it to fix fees. Indeed in a letter dated November 27, 1987, the Treasurer of the Law Society advised all members that the Society's ruling body now regards certain tariffs of fees established by county and district law associations as unauthorized conduct and grounds for disciplinary action.[14]

What makes this case even more disturbing is that it is part of a pattern. In a recent speech to the Law Society of Upper Canada Program on Competition Law, the DIR said:

> As I indicated in my earlier speeches, greater use of alternatives to contested litigation, including the consent order route, can achieve timely, less costly and effective results in appropriate circumstances. Over the past two years, we have been successfully making greater use of the prohibition order provisions on a consent basis in relation to criminal sections of the Act.[15]

If price-fixing by a bar association represents appropriate circumstances for the issuance of a consent order, the mind boggles at the prospect of similar attempts being made to save resources in other areas of criminal law enforcement. Whatever happened to the idea of deterrence and the resources that can be saved by self-policing? It appears that the DIR wants to take us back to the *Combines Investigation Act* of 1910, under which the crime consisted only in continuing to operate the combine after it had been condemned (Gorecki and Stanbury, 1991).

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[13] Director of Investigation and Research, *Annual Report for the year ended March 31, 1988* (Ottawa: Minister of Supply and Services Canada, 1988), p. 17.

[14] See *Canadian Competition Policy Record*, Vol. 8(4), 1987, p. 3.

[15] *Canadian Competition Policy Record*, Vol. 10(2), 1989, p. 52. See also *Canadian Competition Policy Record*, Vol. 10(2), 1989, pp. 12-15.

7.0 THE DIRECTOR'S JOB

A fundamental problem with most negotiated settlements is that justice is not seen to be done when the available options are quite unknown to the public, much less when the justification for the DIR's choice among the options is equally unknown (see Maule and Ross, 1989; Stanbury, 1991).

If the DIR does his job well, he must inevitably make some businessmen unhappy. But Ministers will be aware of the large element of discretion involved in the DIR's decisions. Since Ministers will have to live with the resulting criticism from the business community, they will increasingly want to have a say in how the DIR's discretion is exercised. The DIR will be able to resist such pressure in the long way, only if he has developed a constituency of supportive opinion. Justice must be seen to be done.

Of course the DIR may not do his job well. Under a regime of negotiated settlements, firms will recognize that they are involved in a bargaining situation. If they are well advised, they will enter negotiations with intended changes or give-aways dressed up as major concessions. The Bureau, often working under extreme time pressure, will tend to be satisfied if it has successfully insisted on some pro-competitive modification of the original proposal. The over-all impact of the settlement may nevertheless be seriously adverse to the competitive environment.

The public is becoming suspicious about the business reaction to the *Competition Act*. The current state of the law, with little or no jurisprudence in two major areas, implies great uncertainty for business. The absence of much criticism of something that business normally finds highly distasteful, makes the public suspicious that business can count on soft options in the negotiated settlement process. This may not be in fact in the long-run interest of the business community, even if it is advantageous to some in the short-run.

A second fundamental objection to almost exclusive emphasis on negotiated settlements, when the application of the tests in the statute is so uncertain, is that there can be little self-policing by industry. Because there are so few precedents to rely on, even the most law-abiding citizen and the most learned counsel are faced by doubt about what the law on mergers and the law on abuse of a dominant position requires. This maximizes uncertainty for the business community, imposes a cost, and arguably constitutes a drag on the economy.

The other side of the coin is that the Bureau of Competition Policy too is uncertain about what the law requires. If, to be on the safe side, every case has to be treated as though it is unique, the Bureau's resource requirements become almost infinite.

From June 1986 to March 28, 1991, some 790 merger files were opened, relating to examinations that required at least two man days.[16] In 44 cases, a decision was made to monitor the actual effects during the ensuing three year period as provided in the Act. In 39 cases, examination was continuing in the ordinary way at the end of the period. Eleven mergers were voluntarily abandoned in whole or in part because of the Bureau's concerns. In seven other cases the parties undertook to restructure the transactions after closing, to alleviate competition concerns. Five merger applications have gone to the Tribunal for consideration. In three other cases the competition concern was removed by a pre-closing restructuring of the transaction. In two other cases the Bureau has announced an intention to file applications before the Tribunal. To assist in merger assessments, the DIR has indicated that the Bureau augments its staff by bringing in outside economists, lawyers, accountants, and independent industry experts as required.

On its face this represents a remarkable amount of activity to base on the foundation of a highly uncertain statutory provision that up to this point has received no judicial interpretation at all. The application of uncertain tests to the universe of mergers and dominant positions implies almost unlimited resource requirements. It is difficult to believe that one or two substantive judicial pronouncements would not sharply concentrate the focus of the Bureau's activity and save resources for everyone (see also Stanbury, 1991).

If time is indeed running out on the independence of the DIR, different solutions are possible. The appointment of a new DIR makes a change in policy easier. It may be possible to persuade the new DIR to bring more cases before the Tribunal and to rely substantially less on negotiated settlements. It can be argued of course that Tribunal hearings do not guarantee much more openness than negotiated settlements, because, given the sensitive nature of company specific information, tribunal hearings may be held substantially in camera. It is to be hoped however that the Tribunal, and given the appeal provision, ultimately the courts will give great weight to the public's right to know.

The DIR has indicated that the delay, expenses, and uncertainty of the litigation process and the desire to avoid public scrutiny of future business plans, provide a powerful incentive to businesses to avoid contested proceedings.[17] If therefore business is really so wedded to the idea of negotiation that a major shift is not going to happen, then the DIR's accountability can instead be enhanced by making the whole process transparent, for example, by complete disclosure of all the facts on which the DIR relied, say, one year after the decision. The need to preserve the confidentiality of firm-specific information in Canada has often been grossly exaggerated. Some of the claims made to justify confidentiality under the *Canada Corporations Act*, for example, where a multinational enterprise that dominates the Canadian market purports to fear disclosure because this could confer a dangerous advantage on a smaller, local rival, are ludicrous. Routine disclosure of the type required by the Securities and Exchange Commission in the U.S. is long overdue. Free trade will push us in this direction in any event.

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[16] *Canadian Competition Policy Record*, Vol. 12(1), 1991, p. 9.

[17] *Canadian Competition Policy Record*, Vol. 10(2), 1989, p. 16.

Another option, would be to amend the *Competition Act* to permit private parties as well as the DIR to bring cases before the Tribunal. There is a good deal of precedent in the history of the legislation for such an effort to involve the public in enforcement of the law. Public input in the investigation process has been provided for in all legislation since 1910. Public input in the adjudicative process may have political attractions as a safety-valve by providing complainants with a day-in-court, and as a counterweight to the influence of business lobbies. Public input may also be politically attractive as an answer to critics of the DIR's performance.

Unless there is soon a dramatic shift in the accountability of the DIR to the public, we can expect to see evidence of at least an informal Ministerial or Cabinet over-ride of the DIR's decisions. On its face, a Cabinet over-ride may seem to be eminently democratic and to assure coherence in Government economic policy. As a practical matter, it is almost the worst imaginable outcome. No busy Minister has the time or inclination to examine carefully all the facts in a typical antitrust case. An over-ride decision by the Cabinet would likely reflect a very superficial review, in which the most influential input, in all probability, would originate with business lobbyists.

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Chapter 26

A BRITISH LOOK AT CANADIAN COMPETITION LAW AND POLICY

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1.0 INTRODUCTION

In Britain, we have watched with great interest the somewhat drawnout process of reform of Canadian competition policy culminating in the *Competition Act* of 1986. Our own competition legislation (*Fair Trading Act*)[1] is much younger, dating only from 1948. Parts of that legislation now have a dated look and proposals to improve parts of it, notably the law on restrictive agreements, was published by the United Kingdom (UK) Government in 1989.[2] Further proposals are a possibility, and I have little doubt that the Canadian *Competition Act* will be closely examined for any lessons that we can learn from Canadian experience.

I propose to identify and comment upon some of the more striking features of the Canadian system, as they appear to a Briton, with some reference to the British position.

2.0 ROLE OF THE DIRECTOR

Perhaps the most striking feature of all is the role and power of the Director of Investigation and Research (Director). There is nothing comparable in the UK to the range of the Director's investigatory and executive powers. With a warrant of the court, the Director (or his staff) can search premises and seize any material relevant to his enquiries; with an Order of the court, he can require a person to produce records, make written returns or be examined orally. I understand that these powers are of considerable importance in the enforcement of the Canadian legislation, and not only in cases of criminal conspiracy where the search and seize powers are widely used, but also in cases involving practices covered by the non-criminal provisions, including mergers. The Director also enjoys a range of alternative remedies for resolving cases into which he has enquired. It is clear that in the last three years the Director has attempted to apply these remedies in a flexible way with the object, wherever possible, of avoiding contested proceedings before the courts or the Competition Tribunal (the Tribunal) in favour of alternative "more timely and less costly" remedies.[3] This is nowhere more obvious - and, no doubt, nowhere more significant - than with the control of mergers. As Director, Mr. Goldman made very clear his preference to "fix it first" by seeking pre-closure restructuring of the merger transaction or by taking undertakings from the parties as an alternative to an application to the Tribunal. Given the delay, cost and uncertainty, the alternative remedies available to the Director give him considerable power over the destiny of merger proposals, with the Tribunal delegated to a secondary role.[4] I am aware that this deliberate policy of the Director has led to such criticisms as "in practice, the Director is policeman, prosecutor, judge, jury and probation officer."[5] If this is fair comment - and it is not for me to say whether it is - then any judgement about its consequences must depend upon the effectiveness of the Bureau's extensive compliance programme, the competence of the merger review conducted by the Bureau, the fairness and openness of its proceedings and the premium that is attached to speedy resolution of merger cases.

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[1] See the discussion in Lane in Part 9 of this volume.

[2] White Paper, *Opening Markets; New Policy on Restrictive Trade Practices* (London: Cmnd, July 1989).

In the UK there is a separation of roles and a division of power between the Director General of Fair Trading (DGFT) who initiates cases, the Monopolies and Mergers Commission (MMC) and Restrictive Practices Court

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[3] See Director of Investigation and Research, *Program of Compliance*, Information Bulletin No 3, (Ottawa: Bureau of Competition Policy, June 1989); and the paper by Goldman in Part 9 of this volume.

[4] It could be argued that the "fix-it-first" approach means that very few cases will go to the Tribunal for adjudication. As a result, the adjudicating body's interpretation of the merger provisions is much slower to develop.

[5] D.E. Wires, "Merger Regulation in Canada: Proposal for Amendment," (Unpublished paper, 1988), p. 3. See also C. Maule and T. Ross, "Canada's New Competition Policy," *George Washington Journal of International Law and Economics*, Vol. 23, 1989, pp. 59-109. Eds. note: It must be emphasized that the Director is responsible for investigation of both civil and criminal matters under the *Act*, while adjudication is the responsibility of the courts for criminal offences, and the Competition Tribunal in the case of civil reviewable matters. However, the Director does have the power to "negotiate settlements" in merger cases in the sense of specifying the conditions under which he would have no reason to challenge the merger.

(the Court) who adjudicate on cases, and the Minister who decides what shall be done - except for restrictive agreements and resale price maintenance which are dealt with by the Court. In his initiating role, the DGFT has very limited powers, far short of those available to the Director, while the MMC's investigatory powers also do not extend to search and seize powers. However, the Government is proposing an enhancement of the DGFT's powers, including the power to search premises and seize documents as part of its proposed reform of the law on restrictive agreements;[6] and, of course, European Commission officials have those powers for the enforcement of the competition rules of the Community, rules which are directly applicable within the UK.

The DGFT is also about to get a new power under the merger control provisions - a power to accept an undertaking by the parties to divest or otherwise restructure the proposal to remove any competition problem and avoid the Minister needing to refer the merger to the MMC. These undertakings will be enforceable in the courts. This is a first step down the "fix it first" road, and it will, obviously, enhance the role - and the power - of the DGFT in the settling of merger cases. It is most unlikely, however, to make a substantial difference to the number of cases that are referred to the MMC. The very limited role for the Minister in the Canadian system[7] is a strong contrast with the UK system where the Minister has a decisive role, especially in merger control. He decides whether a merger should be sent for investigation to the MMC (though he has to consider the advice of the DGFT), and the MMC reports to him on the effects of the merger and on any remedies that they think should be applied. This is one factor that needs to be borne in mind in the continuing debate over the proposed European Community merger control regulation by which exclusive jurisdiction to determine the fate of mergers with a "Community dimension" would rest with the European Community.[8]

3.0 THE SUBSTANTIVE TEST: EFFECTS ON COMPETITION

In the UK the substantive test in the competition legislation is whether the matter or situation under investigation (by the MMC or Court) operates against the public interest. The only exception is resale price maintenance which is prohibited (with the exception of books and certain medicaments). So a Briton is bound to remark upon the fact that the substantive test in the Canadian legislation is, invariably, the effect (in some sense or another) on competition with only limited scope for other factors to be brought into the adjudication. The most obvious exception to a strict competition test is the provision in the merger control provisions for efficiency gains attributable to the merger to be offset against any detriments to competition. This is, surely, logical (and it is, certainly, sensible for those claims to be subjected to rigorous scrutiny and to be required to be savings in resource costs).[9] In the UK, in the great majority of cases, we will also be concerned only with the competition effects of a merger and any efficiency improvements it can be shown to generate. But the system does allow a wider range of factors such as effects on regions of the country or on employment to be brought into account and Ministers have made it clear that they reserve the right exceptionally to refer mergers to the MMC, even if no competition issue arises;[10] an example was the shareholding of the Kuwait Investment Office in British Petroleum. And once a merger is referred to the MMC, they are entitled to take into account, in deciding whether or not a merger would be against the public interest, any matter they consider relevant.

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[6] See note 2.

[7] The Minister may influence the appointment of the Director (although the Director is appointed by the Governor-in-Council); he may require the Director to conduct an inquiry (S.12); he may require the Director to make a further inquiry when the Director wishes to discontinue it (S.22).

[8] Generally, see Christian Marfels, "The New EC Merger Controls: An Appraisal," *Canadian Competition Policy Record*, Vol. 11(4), 1990, pp. 58-65.

We were also interested in the way the *Competition Act* spells out several factors[11] that the Director must take into account in his competition assessment of mergers, and explicitly enjoins him not to rely on market share and concentration data. I imagine that competition officials around the world have regard to the factors listed and, with Mr Goldman, to claim they have no "tunnel vision;[12] but it is unusual for them to be spelled out in statute. Does this approach have any advantages over less formal (and more flexible) enunciations of the way a competition assessment will be conducted. Can it not lead to diversionary legal argument about the proper interpretation of these detailed provisions of the statute?

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[9] As outlined in the interesting speech by Calvin S. Goldman, "Mergers, Efficiency and the Competition Act," (Notes for an address to the Commercial and Consumer Law Workshop, Faculty of Law, McGill University, October 15 1988).

[10] See Department of Trade and Industry, *Mergers Policy* (London: HMSO, February 1988).

[11] The factors listed in the statute (S.93) are for guidance and greater certainty only which may and not must be taken into account. The wording in the statute states "may have regard to... the following factors..." The Tribunal (and the Director as such) is however restricted in using "evidence of concentration or market share" as the sole basis for determining substantial lessening of competition. Here S.92(2) uses the phrase "shall not."

[12] Calvin S. Goldman, "Recent Experience with Merger Review in Canada," *Canadian Competition Policy Record*, Vol. 10(2), 1989, pp. 47-55.

4.0 PRE-NOTIFICATION

There are other features of Canadian merger control that interest us. One is the mandatory pre-notification system.[13] In the UK, merger proposals are either brought to our notice by the parties or we hear about them from the financial press. It is rare that we have to deal with a completed merger. However, such cases seem to be on the increase, and we are conscious that, while we may hear of a merger proposal, we will often be short of information about it. Hence the Government is about to introduce a new notification system.[14] But it will be voluntary, the inducement to notify being clearance within four working weeks in straightforward cases where more information than that required with the notification is not needed. We studied the Canadian notification system before the Government's proposals were settled. A mandatory system was rejected as unduly burdensome on both industry and the competition authorities. I appreciate that, in Canada, you might have more of a problem in dealing with completed mergers without a notification system, and that the system may have a symbolic significance in the shift from a moribund criminal procedure to a most actively enforced merger review under the civil provisions of the Act. But, to us, the Canadian notification system seemed very burdensome in the amount of information it requires while rarely eliciting more than minimal market information except where the parties choose to include a competition assessment or brief on their own volition.

5.0 CRIMINAL PROVISIONS: VERTICAL RESTRAINTS

I expect that the decriminalisation of the merger control will prove - if it has not already proved - to be the most significant of the reforms of the *Competition Act*. I can understand why conspiracy was left as a criminal offence.[15] More puzzling is that predatory pricing, price discrimination, resale price maintenance, deceptive marketing practices, and misleading advertising should also remain within the criminal provisions of the 1986 Act, given enforcement experience on these matters in many countries and contemporary economic thinking about discrimination and vertical restraints. In the UK we have no specific statutory provisions on price discrimination or predatory pricing. However, such practices can be investigated if their effects are considered anti-competitive or found to be a step taken to maintain or exploit a monopoly - which in UK law requires a market share only of 25 per cent or more.

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[13] See R.J. Roberts and C. Hewitt, "Pre-merger Notification in Canada," *Canadian Business Law Journal*, Vol. 11(2), 1986, pp. 135-146; and Howard I. Wetston, "Notifiable Transactions Under the Canadian Competition Act," *Antitrust Law Journal*, Vol. 57, 1989, pp. 907-922.

[14] Eds. note: We could find no record that the U.K. government did so up to June 1991.

[15] See the discussion by Stanbury in Part 2 of this volume.

A major issue for the UK competition authorities has arisen from the growth of the large retail groups, particularly in groceries. Their enhanced buying power has enabled them to extract discriminatory favourable terms, particularly discounts, from their suppliers. Smaller retailers claim this is unfair, and that it distorts competition at retail level. Their representatives have pointed to the *Robinson-Patman Act* in the United States and the provisions on price discrimination in the competition legislation of Australia, Canada[16] and West Germany as enlightened examples of legislation that should be adopted in Britain. So far, these ideas have been resisted,[17] not least because the enforcement record in these countries is far from encouraging, certainly if the objective is the promotion of competition and efficiency. But the problem of buying power, whether and how to deal with it, rumbles on as an issue in the UK. As far as I know there has been little enforcement of the Canadian price discrimination provisions and I wonder how far their criminal status has deterred the Bureau.

6.0 ABUSE OF DOMINANT POSITION

On the civil side, the abuse of dominant position provisions[18] are of particular interest to us as there are tentative thoughts in the UK that if our law on restrictive agreements is changed to make it an offence to operate an agreement which has, or may have, damaging effects on competition, then it would be logical to replace our widely drawn provisions on monopolies and anti-competitive practices by a prohibition of conduct that amounted to an abuse of a dominant position. Your provision, of course, replaced the criminal offence of monopoly; ours would replace a wide discretion for the DGFT to initiate investigations where he thought a monopoly existed and might be being abused or, alternatively, an anti-competitive practice was being engaged in (two statutes are involved, with somewhat different criteria and procedures). Either way, the abuse or practice could only be prevented, or otherwise remedied, after a finding by the MMC that it was against the public interest, and any remedy would bear only on the investigated firm. The deterrent effect of the UK law in this area is weak.

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[16] See Director of Investigation and Research, *Price Discrimination, Section 50(1)(a) of the Competition Act*, Discussion Paper (Ottawa: Bureau of Competition Policy, July 1990).

[17] See Monopolies and Merger Commission, *Discounts to Retailers* (London: HMSO, 1981); and Office of Fair Trading, *Retailing and Competition* (London: HMSO, 1985).

[18] See the discussion by Thompson in Part 4 of this volume and of the first case brought under sections 78 and 79: D.N. Thompson, "NutraSweet: The Evolution of the Law on Abuse of Dominant Position," *Canadian Business Law Journal*, Vol. 18(1), 1991, pp. 17-42.

We would agree with Anderson and Khosla of the Bureau of Competition Policy when they describe the abuse approach as "consistent with important aspects of modern anti-trust thought"[19] in its emphasis upon market power as a prerequisite for abusive or anti-competitive conduct and its recognition that particular actions may be anti-competitive, competitively neutral, or even pro-competitive, depending upon the circumstances, including - but not only - the market structure. In the UK, one of the concerns will be whether the concepts "market dominance" and "abuse" are not too vague to give rise to more serious penalties than are now available, for example fines.

There are various ways in which a greater degree of certainty can be attempted. One is illustrative lists of abusive or anti-competitive practices of the kind contained in Section 78 of the *Competition Act*. One criticism we hear of this approach is that even if the list is described as illustrative and non-exhaustive, it may come to be regarded as a list of prohibited practices whatever the circumstances of the case. In the UK, any such list would be much more likely to be put into supporting regulations rather than into the statute itself; this, to some extent, reduces the risk of misconceptions about the status of the list, and it also allows more flexibility in varying or adding to the list. It is interesting that all the practices listed in Section 78 are exclusionary in nature. Similarly, with those reviewable practices on which there are still separate provisions in the Act - exclusive dealing, tie-in sales, and refusal to supply (any of which, it appears, could also be an abuse of a dominant position).

7.0 EXPLOITATION OF MARKET POWER

In the UK it has long been part of the tradition of monopoly policy to investigate whether firms which have a dominant market position have abused their market power by exploiting it - by charging higher prices, or tolerating higher costs, than would be expected in a more competitive market. When a monopoly situation is referred to the MMC they, invariably, analyse the profitability of the leading firms in the market. Using this, and other information, for example international price comparisons, they attempt a judgement on whether the level of prices is too high. In about a third of the relevant cases upon which they have reported the MMC have concluded that the level of prices and profits has been too high.[20] They have sometimes recommended steps to increase competition, for example by liberalising restrictions on entry or by requiring greater transparency in the costs and prices of a dominant firm, but sometimes they have recommended that the firm should be subjected to a system of price control (supervised by the Office of Fair Trading).[21] Where a firm is a natural monopolist or entry into its market is effectively blockaded, price control is a logical remedy, though the familiar concerns about the reduced incentives to efficiency and the costs and rigidities of the regulatory mechanism are fully appreciated.[22]

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[19] R.D. Anderson and S.D. Khosla, "Reflections on McDonald on Abuse of Dominant Position," *Canadian Competition Policy Record*, Vol. 8(3), September, 1987, p. 7.

[20] See the paper by A.J. Lane in Part 9 of this volume.

The point I wanted to make is that there seems to be none of this in Canadian competition law and policy. There are horrendous difficulties in deciding whether a level of price is "excessive" and there may be no easy remedies where it is decided that it is. Tempting therefore to leave solutions to the market; but even where new entry is possible, it can take a very long time to occur and to constitute more than a toe-hold challenge to the entrenched firm. We see no reason in these circumstances why the authorities should not intervene to protect the interests of customers. Our discretionary, essentially administrative, system remains useful for this purpose.

8.0 MERGER AND ABUSE OF DOMINANT POSITION: THE INTERFACE

There have been very few cases under the abuse of dominant position and the other provisions on reviewable matters.[23] The criteria in Section 79 for there to be an abuse of a dominant position are demanding (even if "consistent with modern anti-trust thought") and I imagine that even with the Director's considerable investigatory powers it is as difficult in Canada as in the UK to get the evidence and information to show that a company has overstepped the fine line between abusive, anti-competitive behaviour and legitimate - even if aggressive - market conduct.

It has been argued that the Director should make more use of the abuse provisions in the Competition Act, and concern himself less with mergers: "Reasonable doubts about market definitions, anti-competitive effects, and potential gains in efficiency should all be resolved in favour of the proposed merger. In short, the Director ought only to intervene in the very clearest of merger cases when there seems no other real options."[24] The abuse provision is seen as a useful long stop means of dealing with any anti-competitive merger which should escape challenge under a more relaxed merger control regime. This argument is unlikely to convince competition officials. The effects of mergers are, inevitably, difficult to assess since they lie in the future and must be speculative. But a merger will be extremely difficult to undo in the future (if the powers exist) if the resultant changes in market structure are abused. And experience shows that few examples of post-merger abuse are brought to the attention of the authorities - there can be no notification system for abuse of a dominant position!

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[21] For relatively recent examples see the reports of the Monopolies and Mergers Commission on *Contraceptive Sheaths* (London: HMSO, 1982); and *White Salt* (London: Cmnd 9778, June 1986).

[22] In one case these concerns led the MMC to reject price control. See Monopolies and Mergers Commission, *Tampons* (London: Cmnd 1705, January 1986).

[23] The *NutraSweet* case was decided in the Director's favour (1990) 32 C.P.R. (3d) 1. See Thompson, *supra*, note 18.

[24] Bruce C. McDonald, "Competition Bureau handles challenging job," *Financial Post*, 10 August 1988.

In my view therefore there is a need for a vigorous and effective merger control, however sophisticated and modern is the abuse control; particularly is this so if that control deals only with exclusionary and not with exploitation abuses as in Canada. In the cause of pursuing the objectives of the *Competition Act* - primarily to maintain and encourage competition in Canada to promote the efficiency and adaptability of the Canadian economy in order to expand opportunities for Canadian participation in world markets - it is no surprise that the Director has placed such emphasis upon merger control.

9.0 CONCLUSION

We, in the UK, have benefited considerably from our association with the Bureau of Competition Policy in the last few years, and our exchange of views and information on merger policy and merger review have been particularly valuable. We find that we tackle the analytical and assessment problems thrown up in merger cases in similar ways. Economics, after all, knows no international boundaries and merger review is at heart an exercise in economics. Similar remarks could be made about abuse of dominant position. But, despite our historical links, there are significant differences in the institutions involved and in their powers and procedures. These give distinctive features to any country's competition law and policy. I have tried to draw out some of these in this short paper.

Chapter 27

COMPETITION POLICY: RECENT LESSONS FROM BRITISH EXPERIENCE

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Competition law in the United Kingdom has evolved along rather different lines from that in Canada, the United States and the European Community. At the same time the underlying problems facing the competition authorities in different industrialised market economies are often very similar. I believe it may be of most interest to Canadian readers if I illustrate these differences and similarities in action by giving some recent examples of how the system in our country actually works. They will then be able to decide whether it is the differences or the similarities that are more striking.

1.0 LAWS AND INSTITUTIONS OF UK COMPETITION POLICY

What distinguishes our competition law from that in Canada, the U.S. and the EC is the extent to which the latter all rely on substantive provisions specifying in advance what kinds of conduct are prohibited or otherwise disapproved of. By contrast, our system of competition law relies on case-by-case enquiries, with a minimum of substantive law laid down in advance. The final say is reserved to the discretion of the relevant Minister, rather than to a court or tribunal detached from the political process. The Minister's discretion is very wide, both in terms of the range of mischiefs he can address and the range of remedies he can order. Thus, where some countries' competition laws define in advance what forms of conduct they wish to prohibit, ours are more agnostic. Instead of taking a view in advance on what should or should not be permitted, ours provide for the examination of individual cases on their merits without preconceptions, to see whether anything can be found, as the law puts it, to "operate against the public interest."

The Office of Fair Trading is charged with initiating proceedings under these competition laws, and then, when these proceedings have run their course, with overseeing the ensuing remedies. In the case of monopolies[1], mergers and anti-competitive practices[2], such proceedings lead through the Monopolies and Mergers Commission, which is an administrative body charged with making detailed and impartial investigations, and reporting to the Secretary of State for Trade & Industry. The Commission's findings have legal consequences in that they trigger the power of the Secretary of State for Trade and Industry to order remedies. However the case is different with restrictive agreements[3] and resale price maintenance[4]: with these the route leads from the Office of Fair Trading to the Restrictive Practices Court, (failing undertakings to abandon or modify them), and the Court has its own power to strike them down.

This system of competition law is not without critics in our country, who argue that it is too open-ended. They say that from the businessman's point of view it doesn't enable him to know with predictability where the goal-posts are, while from the public's point of view it lacks that most vital function of all laws, namely deterrence. It is not my object today to debate the relative merits of the differing legal structures. Frankly I see the force of the criticisms of the British system, but I also think it has demonstrated the flexibility to adapt itself to new problems, while other more *a priori* structures sometimes seem to find themselves on a Procrustean bed. One of the features of our system is the wide scope it provides for economic appraisal. What in other jurisdictions is often a matter mainly of legal interpretation is in the United Kingdom usually a matter mainly of the analysis and evaluation of economic consequences.

I should add however that our competition laws have evolved. Not, it is true, over nearly so long a period as Canada's. But even in the 40-odd years since our original competition statute in 1948, experience has prompted subsequent laws, some of them creating a stronger presumption against particular practices, notably restrictive agreements and resale price maintenance. This process is continuing. It was carried further by proposals published by our Government this summer for stronger legislation prohibiting restrictive agreements.[5] On a broad view, therefore, our system of competition law can perhaps be seen as consisting of a generalised facility for agnostic enquiry, as a result of which more focussed measures emerge from time to time. There is some debate in the U.K. about whether there should now emerge a more focussed prohibition of abuses of dominant positions.

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[1] *Fair Trading Act*, 1973 (amending earlier legislation of 1948 and 1965).

[2] *Competition Act*, 1980.

[3] *Restrictive Trade Practices Act*, 1976 (amending earlier legislation of 1956).

[4] *Resale Prices Act*, 1976 (amending earlier legislation of 1964).

2.0 MONOPOLIES

The differences I have referred to are perhaps greatest in relation to monopolies. Where other jurisdictions prohibit abuses of dominant position, British competition law, without prohibiting anything in advance, provides for the examination not only of the conduct of monopolies but of their structure as well.

Like other competition authorities, we follow the debate within the economics profession about the causes, effects and durability of monopoly power. Should we view monopolies as like sand-dunes, created overnight by "the perpetual gale of creative destruction" which is the competitive process, and liable to be destroyed by the same force just as peremptorily? Or are they more fortress-like structures, protected by "barriers to entry"? If so are such barriers due to some restrictive if unwitting side-effect of government action, or to exclusionary abuses by the monopolist itself?

In the face of these doctrinal questions, our approach aims to be eclectic and empirical, not beholden to any school of theory whether neo-classical, Chicago or Austrian. Our law defines monopoly rather broadly, as more or less any position of market power, tested by a 25% market-share. But we do not regard market-shares as more than the starting-point for analysis. We view competition as a dynamic and Darwinian process. We recognise that a monopoly position, and the monopoly profits that may go with it, may often be the reward of superior foresight and efficiency rather than the ill-gotten gains of monopoly power. We accept that such profits may often be quite evanescent, and that they can act as a beacon which best attracts new entrants when left to shine brightly. But we also feel we cannot be indifferent to the time this process takes. Granted the in-built market forces tending to erode monopoly power, the speed at which the tendency works itself out seems to be extremely variable.

2.1 Examples

This variability can be illustrated by a spectrum of examples. At one end of this spectrum, the Monopolies and Mergers Commission found in a monopoly report published in 1989 that the monopoly profits in issuing credit cards[6] had been built up, and were now in the process of being competed away, all in the space of a few years. In another report in 1989, while they found monopoly profits in the manufacture and fitting of artificial limbs,[7] and recommended divestment, subsequent events look as though they might have undermined the power of the monopolist, as our National Health Service has girded itself to make more strategic use of its buying-power over these products. In both these cases monopoly profits have proved quite volatile. In a third report in 1986, the Monopolies and Mergers Commission found that, although the leading producer of sanitary tampons[8] had made monopoly profits for many years, its high profitability was due to its efficiency rather than to exploitation of its monopoly position. And since there were no detectable anticompetitive practices or other barriers to entry, they concluded that no harm was done if such profits were allowed to continue as an example to others of the rewards efficiency can bring. Quite different has been the experience with the plasterboard monopoly,[9] where the Commission's recommendations as long ago as 1974, designed to facilitate new entry, seem only now, 15 years later, to be bearing fruit. Here monopoly profit has proved very durable, while in their 1986 report on the white salt[10] duopoly, the Commission concluded that there was simply no hope of monopoly profits being restrained by new entry, partly because of scale economies and partly because (as in the plasterboard case) the incumbents held all the mineral reserves for which planning permission had been granted. They therefore recommended price control, according to a formula designed to maintain downward pressure on the costs of both companies. Not everyone accepts price-control as an appropriate remedy in such circumstances. But few oppose it when applied to public utilities such as British Telecom and British Gas, as it has been, following their privatisation in the last few years. These public utilities after all would scarcely claim to have built up their monopoly power against competition through superior foresight or efficiency. They represent the far end of any spectrum of the durability of monopoly power, partly because of elements of natural monopoly, where it is inherently more efficient to have one rather than two or more suppliers.

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[5] White Paper, *Opening Markets; New Policy on Restrictive Trade Practices* (London: Cmnd 727, July 1989).

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[6] Monopolies and Mergers Commission Report on *Credit Card Services* (London: Cmnd 718, August 1989).

[7] Monopolies and Mergers Commission Report on *Opium Derivatives* (London: Cmnd 630, April 1989).

[8] Monopolies and Mergers Commission Report on *Tampons* (London: Cmnd 1705, January 1986).

[9] Monopolies and Mergers Commission Report on *The Supply of Plasterboard*, January 1974.

[10] Monopolies and Mergers Commission Report on *White Salt* (London: Cmnd 9778, June 1986).

These examples show I believe how variable we have found monopolies to be in the durability of their power, and in the sort of remedies found to be needed in the public interest to curb that power.

2.2 Remedies

The search for remedies for the mischiefs of a monopoly is another distinctive characteristic of the U.K.'s case-by-case system of competition law. Under a prohibition system, the remedy for an infringement may simply be a penalty or an injunction. The task of finding a remedy for the adverse effects of a monopoly is different and often more complex.

Our law gives the Secretary of State wide powers to regulate the conduct of monopolists: but these powers are exercisable only to the extent requisite to remedy a mischief identified in a report by the Monopolies and Mergers Commission (MMC). Broadly speaking remedies are available for three different purposes: stopping particular exclusionary practices which serve to hinder competition entry; controlling prices when the conclusion is reached that competitive entry is impossible in any circumstances; and finally divestment or break-up. This latter has always been regarded as a last-resort measure, recommended extremely rarely. In practice the MMC has usually been concerned mainly to smooth the way for competitive entry. In its 27 enquiries into monopolies over the past 10 years, the MMC have four times recommended some form of price control, twice divestments, and 11 times steps to ease competitive entry.

2.3 Barriers to Entry: The Gas Inquiry as a Case Study

Easing competitive entry often involves tackling several interconnected barriers simultaneously. It can call for a package of interconnected remedies. This is well illustrated by the Monopolies and Mergers Commission's report in 1988 on the monopoly in the supply of gas to industrial users.[11] When British Gas was privatised in 1986 its domestic tariffs were subjected to control, its supplies to business users, sold at negotiated prices, were left uncontrolled. The hope at that time was that the price of business supplies would be adequately constrained by competition from other fuels, supported by a legal requirement on British Gas to carry gas as a common carrier on its transmission network for competing suppliers who, it was hoped, would then come forward from among the companies producing gas in the North Sea. In practice however, common carriage contracts did not emerge, and the Office of Fair Trading soon received enough complaints from industrial gas users about excessive and discriminatory pricing to justify a monopoly investigation by the Monopolies and Mergers Commission.

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[11] Monopolies and Mergers Commission Report on *Gas* (London: Cmnd 500, October 1988).

When the Commission reported it found British Gas's policy was one of systematic discrimination and segmentation of the market. Since industrial users differed in their ability to switch to alternative fuels, each was charged the highest price his individual circumstances would bear. Moreover interruptible contracts, which carried the lowest price, were available only to customers with plant on site for burning alternative fuels, and this appeared to be because, whether or not the customer actually needed such plant, only the possession of it provided a clear demonstration that he could not be forced to pay more.

At the same time the Commission found that the emergence of alternative suppliers using British Gas's network on a common carrier basis was being discouraged in several interconnected ways: first by British Gas's own formidable lack of enthusiasm: second by its unfettered powers of discriminatory predation against any new suppliers that might have emerged: and third by the fact that the only plausible independent suppliers were oil companies exploiting gas fields in the North Sea for which British Gas was bound to remain the most important customer. These were formidable barriers to entry, which made it evident that competition via common carriage could not simply be left to start small and build up: it needed some kind of boost to get it off the ground.

Having arrived at this analysis of the mischief, the Commission recommended that British Gas be required to publish a transparent and cost-related tariff of charges, and to make interruptible supply contracts available to anyone who wanted them. In this way non-cost discrimination would be prevented, and customers who had no access to alternative fuels would get the same terms as those that had. But in addition to this the Commission wished to overcome the barriers to entry discouraging direct gas-to-gas competition. For this purpose they recommended that British Gas be required to publish guidelines on the terms upon which it would carry gas for other suppliers; and also, more controversially, that 10% of the gas coming forward from newly developed fields in the North Sea should actually be reserved for such suppliers. In this way they hoped to secure the establishment of a new industry of independent gas suppliers, extracting gas from the North Sea, marketing it to industrial users, and employing British Gas as a common carrier. It is still too soon to say whether this aim will be achieved.

It will be clear that the gas enquiry brought to light a complex web of barriers to entry, all interacting with one another in quite complex and subtle ways. Their remedies had to take account of these interactions. I believe I am right in saying that it would have been difficult to tackle such a complex web of barriers within a legal framework specifying abuses prohibited in advance.

3.0 MARKET DEFINITION

Defining the relevant market, both as to product and as to territory, taxes all competition authorities. Market definition is sometimes apt to sound arbitrary, as if it were a matter of choice whether to take a narrow market or a broad one. Our clients, in pressing us to adopt the widest possible market definition, often seem to think that a wide definition is just as good as a narrow one, regardless of circumstances. However our approach is to focus on practical questions about how the case before us affects consumer choice. The purpose of defining the market is not simply to permit the calculation of numerical market shares, but to establish the context in which to address the bottom-line questions: does this monopoly restrict consumer-choice and give the monopolist the power to raise prices to the consumer's detriment? Does this merger threaten to do so?[12]

For example, we had to ask ourselves when considering one merger last year, whether there was a distinct market for carpet-tiles, distinguishable from that for carpets. Yes, we concluded, after learning that some users of carpet tiles have to use them in order to get at the cabling under their office floors. Another merger in 1987 led us to ask: is there a market for domestic television rental services, distinct from the retail trade? No, we replied, no longer; in the past, TV rental had offered a number of advantages important to some consumers: long-term product warranty, maintenance, installation and of course credit. But all these were now freely available to retail as well as rental customers: so from the point of view of consumer choice, TV rental and retail seemed now to be close enough substitutes to comprise one market, not two. On these grounds, a large merger in the rental sector was allowed to proceed.

When the territorial boundaries of markets are at issue, the test we apply is again the effect on consumer choice. What was the relevant market when, earlier this year, London's two major pharmacy chains proposed to merge? We concluded that this depended on the location of particular stores: it emerged that none of the newly merged company's branches would lack a competitor close by: so in none of the relevant micro-markets did consumer choice appear to be threatened. When two brick companies proposed to merge in 1988, we learned that on average bricks were used at a radius of 70 miles from the brickworks. This suggested that in the British context brick markets were regional: wider than local but narrower than national: and on account of regional concentration that merger was indeed referred for examination by the MMC.

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[12] To economists I will admit that we do not make explicit estimates of cross-elasticities in order to gauge the degree of substitutability of one product for another. Our approach is more subjective than that. But its orientation is entirely a consumer orientation.

But market definition arouses the keenest debate when markets cross national frontiers. I believe this is true in both Canada and the U.K. Indeed, another thing our two countries now have in common is membership of a large customs union or free-trade area, and you may have found, as we have, that one of the most controversial aspects of competition policy is its interaction with trade policy. Yet controversial or not, international trade is a powerful ally to competition policy. It can often melt the cartels and disarm the monopolies that other measures cannot reach. Three very different examples from our own experiences illustrate this power. The cement cartel survived examination by our Restrictive Practices Court in the early 1960s, and was only abandoned a whole generation later in the face of imports from Greece and Spain, after those countries had joined the European Community. The plasterboard monopoly, although it survived for many years after our Monopolies and Mergers Commission had sought to reduce the entry-barriers, thanks to its tight hold on British sources of gypsum, is now under challenge from another British company obtaining gypsum elsewhere in the Community. And the London Stock Exchange, having been forced to adapt to global securities trading, now bears little resemblance to the body whose fixed commissions and restrictive rule-book were challenged before the Restrictive Practices Court by the Director General of Fair Trading in 1977.

If, we are so often asked, we recognise trade as an ally of competition policy, do we make our competition assessments in the light of national market shares or European market shares? Surely, we are told, in view of plans to create a Single European Market by 1992, only European market-shares can be relevant? To this we say, "Sometimes, but not always." Our approach to this question starts from the recognition that markets consist of consumers and producers. Where do the relevant consumers live? Clearly, for a national competition authority, only British consumers are relevant. Who then are the relevant producers? Are they British ones, European ones, or producers further afield? Our answer to this is that simply any producers are relevant to the assessment, wherever they are, if they can supply the relevant product to British consumers. Those producers may be in the United Kingdom, Europe or beyond. Whether they can supply freely from where they are situated depends upon matters such as trade barriers, if any, transport costs, other barriers to entry, buyer-power and all the many other things that may promote or inhibit the access of buyers to sellers and vice versa. The relevance of 1992 lies in the prospect of existing barriers within Europe being removed. But in many markets the most important barriers to trade within Europe have been removed already, while in others, not all the barriers to entry are of the sort that can be removed simply by governments agreeing to remove them. The pragmatic question is the genuineness of the consumer's access to a variety of alternative suppliers as a restraint on the exploitation of whatever market a merger may create or a leading firm possess. And if the access is genuine the location of the supplier is irrelevant.

Two contrasting examples will illustrate the way this analysis is applied in practice. In 1988 there was a merger between the two main British manufacturers of automotive bearings. Their combined share of the United Kingdom market was 94%. However the competition authorities did not intervene. Was the relevant market national or European? There were strong competitors making such bearings in other European countries and beyond. Their access to the UK market was free from tariff, technical or other barriers. Transport costs were low. There was strong buyer-power in the hands of the motor manufacturers, who are the customers for this product. Most of them were multinationals, and thus well furnished with the information and influence necessary to take an international approach to their procurement of engine parts. And it seemed a reasonable supposition that, since all this was well-known to the merged British company, the fear that customers might switch to foreign suppliers would in this instance exert a strong competitive discipline: in other words "potential competition" was also an important factor. Here was a case where the relevant producers came from everywhere, because there was in all respects genuine and uninhibited access from all directions, so that a high market share within the United Kingdom did not confer market power.

However, in another case in 1988 the Office of Fair Trading had to consider another merger proposal which created a large United Kingdom market-share in glass containers, but, we were reminded, a small European one. Surely, it was argued, the European market share must be the relevant one? But on the facts of this case we eventually concluded that the European market-share was irrelevant, because not only was there was very little trade in this product between Member States of the European Community, but no apparent prospect of any. International trade was inhibited not by the sort of barriers that stood to be removed by Government action, but by the inherent cost and difficulty of transporting such a fragile and low-value product: 1992 wasn't going to chance that. The relevant market seemed to be the national one both now and for the future, and the competition objection to the merger stood.

Thus whether we take a regional, national, European or worldwide approach to defining the relevant market depends not upon our prior disposition, but upon analysis in the particular case of the customer's freedom of access to alternative competing supplies.

4.0 VERTICAL RESTRICTIONS AND VERTICAL INTEGRATION

Vertical restrictions, and vertical integration alongside them, have been the subject of much dispute among competition economists, especially in North America, where it sometimes seems to us that a former distaste for all vertical restrictions has given place in the wind from Chicago to the view that none of them are harmful.

4.1 An Eclectic View

For our part we differ from both views. We accept that a vertical restriction can sometimes be pro-competitive in its general effect. But we do not accept that they always are. The Monopolies and Mergers Commission commented in their gas report that the mischiefs they had found flowed ultimately from the fact that British Gas was in effect two vertically-integrated businesses, one comprising gas supply, in which there is no natural monopoly, and the other gas distribution, in which no doubt there is. When British Telecom bought an equipment manufacturer in 1986, the objections of other manufacturers were understandable, and it was I think hardly surprising that the authorities intervened and permitted the merger only subject to conditions concerning arms-length purchasing. Nor might Mercury Telecommunications have shown such promise as a competitor to British Telecom had not the competition authorities insisted in 1985 that British Telecom allow Mercury's services to interconnect with its own network on acceptable terms. In all these cases vertical integration was found to be a restraint on competition.

So if both extremes are rejected, if vertical ties are sometimes benign and sometimes malignant, we need criteria to determine the point at which they cease to be benign and begin to become malignant. I am sorry to say that precise criteria have eluded us. But broadly we consider, as I believe the Bureau of Competition does, that what makes vertical ties damaging is a degree of market power at either of the two levels concerned. That is, we consider that only a firm with some degree of market power can cause harm through vertical restrictions or vertical integration with either its customers or its suppliers. Such market power was present in each of the three examples given above.

A happier aspect of vertical relationships is buyer-power. If retail chains, or other downstream business customers, are big enough to bargain with their suppliers from strength, yet not so big that they can escape competing keenly with each other, this can be of great benefit to the final consumer, and a salutary competitive discipline upon any market-power that might exist further upstream. This seems, for the present at least, to work well in the British grocery trade, an industry where a highly-concentrated manufacturing sector is much given to deploring the bargaining-strength of the retail sector: a disapproval which the competition authorities do not share.[13] We don't have a *Robinson Patman Act* like the U.S., or any prohibition of price discrimination. We like to see retail chains using their buying-power to the fullest whether it involves discrimination or not, provided that inter-retailer competition is strong enough to compel them to pass the benefits on to the consumer.

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[13] Monopolies and Mergers Commission Report *Discounts to Retailers* (HC 311, May 1981).

One of the mischiefs, we believe, of widespread exclusive distribution arrangements can be that they enable manufacturers to control the structure of the retail trade, and thus prevent retail buyer-power developing to counteract market-strength at the manufacturing level.

4.2 The Tied House System as a Case-Study of Vertical Restrictions

This was very much the issue that emerged in March 1989, when the MMC reported on its investigation of the tied-house system.[14] This is the system under which 75% of what we call pubs (and other countries call bars) are owned by brewers, who dictate their tenants' purchasing policy, not only of beer but of all drinks, while of the remaining 25% of pubs half also have their purchasing policy dictated under the terms of soft loans they have accepted from brewers. This is the vertical dimension of the system. Its horizontal dimension is that the top three brewers are responsible for almost half of beer production, and the top six for three quarters of it, while retail outlets, if they wish to sell alcohol for consumption on the premises, require licences which are fairly difficult for a new entrant to get.

The Monopolies and Mergers Commission found that the tied-house system, combined with the licensing of retail outlets, enabled brewers with tied estates to frustrate the growth of brewers lacking them, to frustrate the growth of independent wholesalers, and to stop a strong independent retail sector emerging. They found it restricted consumer choice in most on-licensed outlets to the products of a single brewer, and hence protected brewers from competition when supplying their own estates. They found this led to wholesale prices that were high, rising in real terms, and which varied in capricious ways reflecting variations in local competition rather than variations in costs. The absence of an independent wholesale trade meant, in an industry where delivery costs were high, that it was hard for any retailer to obtain and stock supplies of drinks from a variety of brewers. And while retailers were compensated for high wholesale prices, in the case of tenants of tied houses, by subsidised rents, often as low as half the market-rent; and in the case of free houses by interest-subsidies on loans, these benefits had proved to be a kind of tender trap, since both classes of retailer paid for them by accepting restrictions on their purchasing freedom, these very restrictions being the means by which the wholesale prices they paid were kept high. The Commission made a telling comparison with the "off licensed" trade, that is the retailing of alcohol not to be consumed on the premises. Here strong independent retailing chains bargain with the brewers from a position of strength, and the products of different brewers meet one another in competition in the same retail outlets. And here consumer choice was wider and price-competition more direct.

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[14] Monopolies and Mergers Commission Report, *The Supply of Beer* (London: Cmnd 651, March 1989).

The Commission recommended that these mischiefs could only be remedied by divestment by the largest brewers of most of their tied houses, by the elimination of tied loans, security of tenure for tenants, and the publication of transparent ex-works prices at which independent wholesalers could collect supplies. These recommendations, which were certainly radical, became the subject of heated political controversy in our country during the summer, a controversy which the Government resolved in July 1989 by a compromise, involving, among other things, reliance on "Chinese walls" instead of divestment. How effective a remedy this compromise will prove is beyond the scope of this talk, but it is the job of the Office of Fair Trading to monitor its effectiveness, which we shall do.

5.0 CONCLUSION

I have relied on real-life examples to speak for themselves because I believe that they provide the best means of conveying our experience of administering our competition laws in practice. Some of my examples will I believe serve to illustrate the differences between our two countries in competition law and policy, and some of them will emphasise similarities. However it is my impression that the day-to-day practice of competition policy in different countries is usually more similar than their laws and institutions are. I imagine this is because the underlying problems are largely the same in all industrial market economies.

Chapter 28

LESSONS FROM THE EXPERIENCE OF OTHER COUNTRIES: AUSTRALIA

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1.0 INTRODUCTION

Australia was one of a few countries which followed the lead taken by Canada and the United States in introducing antitrust laws with the passing of the *Australian Industries Preservation Act* in 1906. However this legislation was ill-fated due to constitutional challenges which have been one of the major early features of Australian anti trust competition law. It is interesting to note that the legislation which suffered early constitutional setbacks in the first decade of its existence was being given a broader interpretation at the time when Australia introduced the first of its modern anti trust laws the *Restrictive Trade Practices Act* of 1965.[1] However it has not been until the 1974 legislation, the *Trade Practices Act*, that Australia has really experienced a period where not only its statutory provisions, but the interpretation of it by the courts and the Trade Practices Commission and Trade Practices Tribunal have permitted such legislation to work more effectively in pursuit of the general aims of such legislation.

It is not my intention in this paper to discuss the operation of the Australian legislation. A convenient summary of the Australian legislation prepared by the Trade Practices Commission (and which of course is fairly basic) can be found in the Trade Practices Commission's *Annual Report* for 1987/88. Obviously, such a basic summary is not adequate for any detailed study; but it does give an overview of the approach of the Australian legislation.

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[1] For a discussion of these "early days" see Donald & Heydon, *Trade Practices Law* (1978) Law Book Co, Chap. 1.

2.0 AUSTRALIA'S APPROACH

A striking feature of the Australian Act is that it is basically American (or what Professor Maureen Brunt who is a member of the Trade Practices Tribunal and I call "Austerican"), especially as most of our commercial laws are basically of English origin.[2] This name was coined by us because of the special features of our law - the legislation has a dual enforcement objective. At the same time it is appropriate in my view to describe the legislation as having a dual enforcement objective. Whilst the courts will be the main avenue for enforcement of the principles of the legislation - i.e. to advance competitive behaviour in the public interest - there is an administrative procedure vested in the Trade Practices Commission, and on appeal the Trade Practices Tribunal, to approve, or authorise as the legislation refers to it, anti-competitive conduct or agreements etc which might otherwise be in breach of the Act. Such authorisation can only be granted if the public benefits that flow from the particular anti competitive agreements or practices outweigh the anti-competitive detriments. As Professor Brunt and I have explained in our overview article,[3] this dual approach does offer opportunity for complexity in drafting.

3.0 PROBLEMS

The Australian legislation has been in force for 15 years and already some clear patterns have developed which, speaking as an individual and not necessarily on behalf of the Commission, one would want to see overcome or at least tackled if the legislation is to achieve its major aims.

(1) The courts in our country have had a tendency to read legislation literally. This approach is one that has created enormous problems for administration of Australian law in the fields of taxation law, corporate and securities law and to a lessor extent trade practices law to name some of the areas. It led to the Federal Parliament passing specific legislation which enabled (almost directed one could say) the courts to take into account the policy objectives of legislation. This could be done by examining not only the words of the statute, but also the parliamentary speeches and accompanying papers (even Law Reform Commission reports) that preceded the legislation. The general unwillingness on the part of our courts to look behind the words

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[2] See Baxt & Brunt, "The Murphy Trade Practices Bill" (1975) 2A *Australian Business Law Review* 3.

[3] *Ibid.*

at the purpose of the legislation still continues to be a major problem for administrators of all legislation.

(2) The second major problem in relation to the legislation and one which I believe needs tackling in the future (and here the Trade Practices Commission is fully supportive of the comments that I would make) is the fact that the courts in this country are (in my humble view) yet to acquire the ability or experience to evaluate economic legislation. In May 1989 a select committee of the Federal Parliament (the Griffiths Committee) recommended that certain changes be made to the courts process in dealing with the difficult areas of mergers and misuse of market power. The Committee made certain recommendations[4] on the use of economic experts on our courts. The Trade Practices Tribunal (which boasted as one of its early members Professor Brian Johns who is now the Deputy Chairman of the Commission) is a mixed, quasi-judicial body which is empowered, and which by the very nature of its responsibilities is required, to examine economic issues in a more detailed way than I believe has been attempted or achieved by our courts, with one or two notable exceptions.[5] The fact that we have only been going for 15 years has meant that we have very few major decisions or determinations by either the courts or the Trade Practices Commission or Trade Practices Tribunal.

(3) Because of the past general unwillingness of our teaching institutions to mix disciplines in their teaching of the law there has been a tendency for lawyers who are the main advocates in this area to be wary of economic issues and often to be unable to cope with them. This is changing, and changing rapidly, but until there is an expansion in the number of lawyers who are both willing and able to deal with economic issues and to argue them fluently and constructively in the courts, until there is a growth in the number of similarly qualified judges who sit in judgment in these case, we will continue to have difficulties in ensuring that the principles of the legislation are developed through the judicial system. This is a matter where North American experience in particular might be usefully followed by Australia but there has been some resistance to the development and embracement of such issues. During my oral presentation I will comment on some interesting examples of this reluctance and indeed in some cases indifference or opposition.

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4. See Recommendation 15 in Appendix A.

5. The High Court's decision in *Queensland Wire Industries Ltd. v. BHP Ltd.* (1989) CCH ATRP 40-925 is an Australian landmark decision. Whilst the court did not deal with the essential facilities doctrine the court was prepared to find that the respondent BHP Ltd. held a virtual monopoly in the relevant market and had refused to supply a potential and actual competitor because it did not want to face competition in the relevant market. The court did not have to grapple with the problem of setting a price for the supply of the relevant goods as the case was eventually settled, but the decision has created a significant benchmark in antitrust law in the country. The implications of this case are likely to be felt for many years to come even though it can be distinguished on its facts.

(4) Needless to say, it is vital that any administrative agency that is given the prime task of dealing with this legislation must be given the necessary resources and support in taking on board its tasks. Until the last two years, one could say (and here I speak not only as an individual but in support of what the Trade Practices Commission has been putting to Government over the years) that the financial support provided to the Commission arguably has been adequate, without being as much as the Commission would like. But in the last two years, with the rapid introduction of deregulation in this country and the considerable widening of the responsibilities of the Trade Practices Commission (many of the now deregulated industries were outside the operation of the Act), the work load of the Commission has increased enormously but the resources have not. At a time when there has been increased merger activity, sadly a significant increase in the proliferation of anti competitive agreements (especially resale price maintenance which is prohibited *per se* in our country), and a greater expectation that the Commission should involve itself in consumer protection work, the Commission has found it extremely difficult to cope with its workload. There is no private right of action in relation to mergers (unless the merger has been consummated where divestiture is available) - but this has been the subject of a recommended change.[6] Litigants face considerable burdens in our court system through the operation of a traditional English system of costs. This has come at a time when there is more and more expectation on the part of the general community that the Trade Practices Commission will take on board the kind of actions that might well have been the subject of private litigation in other countries. The Commission has also been encouraged to continue its more pro-active examination of mergers - a feature strongly supported by the Griffiths Committee.[7]

4.0 THE FUTURE

The Trade Practices Commission faces the task of balancing the need to rationalise the Australian industry - to enable it to compete more effectively internationally - with the need to ensure that the benefits of deregulation (increased competition etc) are passed on to the community. This matter was raised specifically in our 1987/88 *Annual Report*.

> Thus, while reduction or elimination of regulatory controls over business activity has the potential to deliver public benefits through enhanced competition and efficiency, care should be taken to ensure that industries identified for deregulation have market structures and other characteristics which will be conducive to effective

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[6] See Recommendation 5 in Appendix A.

[7] See Recommendations 6, 12 and 14 in Appendix A.

> competition and to fair market conduct following deregulation which is likely to provide net benefits for the community at large....
>
> In the current deregulatory environment, appropriately designed and administered codes of industry practice can offer, in appropriate circumstances, an acceptable compromise between public sector regulation and unrestrained competition, a compromise which offers tangible benefits for business and consumers alike....
>
> Following publication in May 1988 of its major research study *Self-regulation in Australian industry and the professions* the Commission embarked on a program to foster the development of effective industry codes of practice.... (pp. 4, 5).

Our greatest challenges will come in the areas of deregulated industries where the Commission has not had much previous experience or opportunities to become involved. In telecommunications, domestic aviation, financial, rural and other sectors, and now the waterfront and transport generally, we will face significant challenges. We have had a very highly regulated employment sector in this community. As this becomes deregulated and as some of the work practices that have been the subject of protection in previous years become opened up to the operations of the *Trade Practices Act* (insofar as they effect the marketplace) the Commission will be faced with interesting, and at times, very difficult matters. Our ability to attract new staff with the skills to deal with these areas will be tested at a time when we face enormous difficulties because of the public service structure and rules which operate within it in Australia.

Whilst the role of the Commission at this time is seen by many as vital, there are strong views in the community that as we become an international society the role of the Trade Practices Commission will be reduced until it becomes almost superfluous.

The business community continues to express concern at the fact that the Trade Practices Commission by examining mergers (and we have a very high threshold in our legislation of dominance) may be interfering with the market too much. In the last 18 months we have instituted proceedings in two matters out of approximately 100 that have come to our attention; yet there is pressure for us to allow greater flexibility for the creation of international "giants". We are constantly under pressure from other sectors to stop mergers which lead to the creation of one-firm dominance in this country.[8] A small country (in economic terms) such as ours so far removed (in geographic terms) from the rest of the world (and it is only recently that the Federal Government has adopted a much more relaxed attitude to international trade etc) may have to approach these issues in a different way. It is important to note that the Commission is not to take into account foreign ownership of companies (this is a matter for the Foreign Investment Review Board) and this itself creates some tensions for us from time to time.

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[8] In the 1987/88 *Annual Report*, the Trade Practices Commission noted: "The merger provision of the Act, s. 50, is based on prohibitions of dominance in a relevant Australian market. In its administration of s. 50, the Commission seeks to ensure that, within the terms of the Act, any merger approaching dominance is fully tested to ensure that prospective public benefits, including enhanced efficiency, are sufficient to outweigh any potential public detriment resulting from a more concentrated market structure. However, in evaluating mergers under s. 50, the Commission cannot take into account issues of public interest (or weigh public benefit against public detriment) unless an authorisation application has been lodged.

All of this points to an increasing burden on the Trade Practices Commission. Certainly our profile has been raised; whether we will exert much influence remains to be seen.

The Commission considers that major mergers with the potential to establish market dominance should be given wide public scrutiny. It has therefore adopted a policy of suggesting to the parties in such cases that formal authorisation on public benefit grounds be sought. The authorisation procedure is very open. Applications, submissions from interested parties and the Commission's own final decision and reasoning are placed on a public register. In rarer cases, resort to consent orders will provide another avenue for public exposure" (p. 3).

Appendix A

GRIFFITHS COMMITTEE RECOMMENDATIONS

Recommendation 5: The Committee recommends that the private right to injunctive relief in relation to mergers be re-introduced to the *Trade Practices Act* 1974, but that takeover targets and associated persons should be excluded from this right.

Recommendation 6: The Committee recommends that the Attorney-General give a direction, pursuant to paragraph 29(1)(b) of the *Trade Practices Act* 1974, that the Trade Practices Commission continue its policy of giving emphasis to the authorisation process in mergers with the potential for market dominance, to ensure that the process of assessing net public benefit is exposed to public scrutiny.

Recommendation 12: The Committee recommends that the Trade Practices Commission maintain a pro-active approach to the regulation of the merger and misuse of market power provisions of the Trade Practices Act 1974.

Recommendation 14: Pursuant to Recommendation 12, the Committee recommends that the Trade Practices Commission be provided with sufficient resources to enable a pro-active approach to be maintained.

Recommendation 15: The Committee recommends that the role of the Federal Court of Australia in the resolution of matters under Part IV and related provisions of the Trade Practices Act 1974 be retained, but that the Attorney-General adopt procedures to enhance the effectiveness of the Court in this area. Options may include:

- enabling the Court to refer economic issues to the Trade Practices Tribunal with an associated streamlining of the Tribunal's procedures;
- relaxation of the rules of evidence in relation to economic issues considered by the Court; and
- the use of assessors by the Court.

Source: *Mergers, Takeovers and Monopolies: Profiting from Competition*, Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs, May 1989 (Canberra: Australian Government Publishing Service).

Chapter 29

LESSONS FROM OTHER COUNTRIES: THE FEDERAL REPUBLIC OF GERMANY

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In 1889, when Canada adopted its first antitrust law, the Germany economy was comparatively free of internal government intervention but increasingly shielded from import competition by protectionist legislation. Cartels and other restraints of competition were generally accepted by economic theory and most politicians as the product of the freedom of trade and contract. They were tolerated, or even welcomed, as a mitigating factor preventing ruinous competition and thus benefiting both specific sectors of the economy and the economy as a whole.

1.0 LEGAL CARTELS

In 1897, the Reich Supreme Court confirmed the lawfulness of cartels. In the Saxonian Wood Pulp Producers Association case,[1] a number of wood pulp producers had concluded an agreement which aimed at "avoiding ruinous competition" among producers and at "securing adequate prices." The Court held, among other things, that a slump in prices endangering one sector of the economy has to be considered as detrimental to the economy as a whole, and that agreements among producers to maintain a reasonable price level are, therefore, also in the interest of the public in general. The Reich Supreme Court confirmed furthermore the principle of the freedom of contract including an almost unlimited freedom to restrict oneself and one's competitive freedom of action by contract. In the absence of such aggravating factors as an intent to establish a monopoly or the usurious exploitation of consumers, agreements of the type in question were accordingly to be considered lawful.

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[1] B. v. .den Sachsischen Holzstoff Fabrikanten-Verband, RGZE 38, 155.

For many years, case law conformed in general with the ruling in the Saxonian Wood Pulp case. The legality of cartels and other restraints of competition was generally governed by Sections 134, 138 and 826 of the *Civil Code* after it came into force on January 1, 1900, and by Section 1 of the *Act against Unfair Competition* which was enacted in 1909. Section 134 of the *Civil Code* provides that any transaction contrary to law is void. This provision has played a relatively insignificant role in connection with restraints of competition. Of somewhat greater importance were Sections 138 and 826 of the *Civil Code* and particularly Section 1 of the *Act against Unfair Competition*. Section 138 of the *Civil Code* provides that a legal transaction contrary to good morals is void. Section 826 of the *Civil Code* provides that a person inflicting injury on another by conduct contrary to good morals must compensate the injury. Section 1 of the *Act against Unfair Competition* provides that a person who, while engaged in business competition, commits acts which are contrary to good morals, may be ordered to cease and desist from such acts and to compensate any damage suffered by others. In general, the courts were reluctant to apply any of these standards to the activities of cartels and monopolies. Only in exceptional cases, e.g., when a practice actually threatened the existence of a competitor, the courts found a violation of the law. In even more exceptional cases, criminal action against cartel and monopoly activities was taken under the sections of the *Penal Code* on extortion and usury.

2.0 CARTEL ORDINANCE

After the First World War the accelerating rate of inflation and the growth of cartelization led, for the first time in Germany, to pressure strong enough to force the Government to take legislative action. On November 2, 1923, the German Government, with the consent of the Reichstag, enacted the *Ordinance against the Abuse of Powerful Economic Positions*, the "Cartel Ordinance"[2], which was based on the *Empowering Act* (Ermächtigungsgesetz) of October 13, 1923. The purpose of the *Cartel Ordinance* was to re-establish the free functioning of the market and to combat artificial restrictions on production. This *Ordinance* was the first German law which can be qualified with some justification, a cartel law in the modern sense. It did not make cartels illegal *per se* ("prohibition principle"). Under the *Ordinance*, cartels were legal in principle, but subject to control in order to ensure that they were established for acceptable, or at least tolerable, ends and used tolerable means. Under this "abuse principle," private restrictions on competition became unlawful only when they were abusive. In order to facilitate supervision of cartel agreements, Section 1 of the *Cartel Ordinance* required all such agreements to be in writing. The *Ordinance* was to be implemented by the Reich Minister of Economics and the Cartel Court.

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[2] (Verordnung gegen den Missbrauch wirtschaftlicher Machtstellungen, or Kartellverordnung) RBG1. 1067

The Reich Minister of Economics was empowered under the *Cartel Ordinance*, if the economy as a whole or the public welfare would otherwise be endangered, to take, *inter alia*, the following measures:

- to request the Cartel Court to take certain actions against cartels,
- to order that participants in an agreement or a resolution may cancel their participation at any time,
- to request the Cartel Court to impose fines in cases of violations of the *Cartel Ordinance*.

The *Cartel Ordinance* provided that a threat to the economy as a whole or to the public welfare would be presumed when a cartel arrangement limited production or distribution in a way not justifiable by the overall economic situation, served to increase prices or to prevent price decreases, or unduly restricted entrepreneurial freedom by limiting purchases or sales or by establishing discriminatory prices or conditions of doing business. The Cartel Court had, *inter alia*, the following powers:

- At the request of the Reich Minister of Economics, to declare void agreements or resolutions, or to prohibit specific conduct implementing agreements or resolutions, if they threatened the economy as a whole or the public welfare,
- to enter an order permitting parties to an agreement or resolution to withdraw at any time,
- upon request of the Reich Minister of Economics, to permit enterprises to cancel agreements with enterprises which had abused their economic power, if the abuse threatened the economy as a whole or the public welfare,
- upon request of the Reich Minister of Economics, to impose fines and/or prison sentences for violation of the *Cartel Ordinance*.[3]

The jurisdiction of the Cartel Court was exclusive and its decisions final, binding the regular courts as well as arbitration panels. If in proceedings before other courts issues arose which were within the jurisdiction of the Cartel Court, the other courts had to submit the issues to the Cartel Court and stay their proceedings pending the decision of the Cartel Court.

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[3] RGB1. 943

On the whole, it seems fair to state that the *Cartel Ordinance* as construed and enforced was not very successful. Firstly, it was interpreted to cover only restrictions on competition "for a common purpose," or essentially horizontal restrictions, excluding such vertical restraints as exclusive dealing agreements and resale price maintenance. In addition, it was construed to cover only "agreements" which constituted binding contracts under the *Civil Code*. This interpretation excluded non-binding "recommendations," gentlemen's agreements and concerted action. Further, although specific intent to monopolize was not required under the *Ordinance*, the Cartel Court did require proof of a "purpose" to influence market conditions. The limited substantive scope of the *Cartel Ordinance* was even further restricted by judicial interpretation. In particular, the rules applying to the abuse of an economically powerful position were narrowly construed by the courts and never applied in practice.

During the Nazi regime, free market functions were replaced step by step by direct government control and direction. Finally, in 1943 all market-regulating functions were transferred to the official organizations of trade and industry (Organisationen für gewerbliche Wirtschaft). In fact, this measure repealed the *Cartel Ordinance*.

3.0 POST WORLD WAR II OCCUPATION LAWS

The defeat of the Nazi regime in 1945 led, among others, also to a fundamental reorientation of economic policies in Germany. An important element of this process was the Western Allied competition legislation. In the absence of a program acceptable to the Soviet Union, the Military Governments of the Western Allies enacted legislation aiming at deconcentrating and decartelizing the German economy as well as at preventing future restrictive and monopolistic arrangements. The laws of the American and British Zones were practically identical.[4] The purposes of the U.S. and British laws were stated as follows:[5]

> "... (I) to prevent Germany from endangering its neighbours and again constituting a threat to international peace;
> (II) to destroy Germany's economic potential to wage war;
> (III) to ensure that measures be taken for Germany's reconstruction consistent with peaceful and democratic purposes;

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[4] Military Government Law No. 56, "Prohibition of Excessive Concentration of German Economic Power," of January 28, 1957 (for the U.S. Zone and Bremen), *Military Government Gazette* Issue C at 2, U.S. Zone Germany, April 1, 1947; effective since February 12, 1947; Military Government Ordinance No. 78, "Prohibition of Excessive Concentration of German Economic Power" (for the British Zone, except Bremen), *Military Government Gazette* No. 16, at 412; effective since February 12, 1947.

[5] See Preamble of Law No. 56 and Ordinance No. 78.

(IV) to lay the groundwork for building a healthy and democratic Germany."

Article I of both laws prohibited "restrictive and monopolistic enterprises and practices." Article II prohibited Germany participation in international cartels. Article III provided for exemptions from these prohibitions. Article IV described the duties of the implementing authorities and the enforcement procedures. Article V defined the terms used in the laws, such as the categories of prohibited practices. Article VI repealed previous inconsistent Germany law. Article VII provided the power to impose fines of up to 200,000 Reichsmarks and/or imprisonment of up to 10 years, and Article VIII stated the effective date of these laws.

The French law, *Ordinance No. 96*, was less detailed and prohibited in general "excessive concentration of economic power," and made restrictive agreements subject to control according to the principles of French law.[6] Under French law, cartels were subject to control and not prohibited *per se*. After 1950, however, this provision was interpreted as a prohibition from which exemptions could be granted.

The enforcement agency for the American and British laws was at first the U.S.-British Bi-Partite Decartelization Commission (BIDEC) and, after September 21, 1949, in accordance with the *Occupation Statute* (Besatzungsstatut) of May 12, 1949, the Decartelization and Industrial Deconcentration Group (DIDEC).[7]

In 1949, the Federal Republic of Germany was established. Under paragraph 2(b) of the Occupation Statute of May 12, 1949, it was agreed that administration of the Allied antitrust laws continue under the jurisdiction of the Allied authorities.[8] In 1951, however, jurisdiction in cases of dispute regarding application of the Allied laws was transferred to the regular German courts.[9] In 1955,[10] the Federal Minister of Economics took over responsibility for the administration of the Allied antitrust laws. Under the Rome

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[6] Military Government Ordinance No. 96, of June 9, 1947 (for the French Zone) 2 Journal Officiel du Commandement en Chef Francais en Allemagne.

[7] Order No. 2 to Law No. 56, Military Government Gazette issue L, at 6, U.S. Zone Germany, December 26, 1948.

[8] Occupation Statute of May 12, 1949, (1949), Allied High Commission for Germany, Official Gazette, 13.

[9] Decision No. 10 of the Council of the Allied High Commission; Programme for the Revision of Occupation Controls, (1951) OG/AHC 794.

[10] Protocol on the Termination of the Occupation Regime in the Federal Republic of Germany, October 23, 1954, (1955), BGB1. II 213, and Convention on the Settlement of Matters Arising out of the War and the Occupation, (1955) BGB1. II, 234.

Convention, these laws remained applicable as German law until the Federal Republic's own antitrust law came into force in 1958.[11]

The Allied decartelization and deconcentration laws have been criticized as failures. Still, it seems fair to state that the present German cartel law is inconceivable without this postwar experience. Although the Allied laws had little lasting direct effect, they contributed substantially to a better understanding of the benefits to be derived from a free market economy, and under this aspect they can be considered a political success.

4.0 1949 LEGISLATION AND LATER AMENDMENTS

Preliminary work on a German antitrust law was officially initiated in March 1949 by a Memorandum of the Western Allies. The Memorandum required the German law to be based on Chapter V of the Havana Chapter. A first draft of an *Act for the Protection of Economic Competition* was submitted to Parliament already in July 1949. Although this draft was not accepted, it had a lasting effect in the following years. It provided, among others:

- A prohibition of cartels and similar arrangements, from which exemptions could be granted only under narrowly defined conditions;
- Provisions governing deconcentration and divestiture of both single enterprises and mergers;
- Control provisions permitting intervention against abuses of economic power;
- Provisions encouraging effective competition;
- Establishment of an independent Monopolies Authority (Monopolamt) with broad powers;
- Criminal sanctions against violations of the law.

In the following years, further drafts were introduced in Parliament and controversially discussed. The controversy resulted primarily from a conflict between opposing philosophies of antitrust regulation. Advocates of the "prohibition principle" (Verbotsprinzip) followed to a large extent the model of the United States antitrust laws. Advocates of the "abuse principle (Mißbrauchsprinzip) favored the European antitrust tradition under which monopolistic practices and restrictive agreements are on principle tolerated and only subject to government supervision and intervention in case of abuse.

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[11] Convention on the Settlement of Matters Arising out of the War and Occupation, Part I, Decision No. 36 of the Council of the Allied High Commission of May 4 (1955) 1955 OG/AHC 3248.

The final compromise draft of July 1957 was adopted by Parliament on August 9, 1957.[12] The *Act against Restraints of Competition* (Gesetz gegen Wettbwerbsbeschrankungen = GWB) came into force on January 1, 1958; as of that date all previous cartel laws, Allied and German, were repealed (Section 109 GWB).

As enacted in 1957, the *Act against Restraints of Competition* established already the basic principles of the Federal Republic's present antitrust law. It prohibited horizontal agreements in restraint of competition (cartels). It prohibited resale price maintenance, although with a broad exemption for branded goods. It empowered the Federal Cartel Office to intervene against abuses of certain other types of vertical restraints and against abuses of monopoly power.

The most serious gap was the absence of any effective regulation relating to mergers. The *First Act to Amend the Act against Restraints of Competition* of 1965 remedied some minor deficiencies without, however, closing this gap.[13] The *Second Act to amend the Act against Restraints of Competition* of 1973,[14] brought far more substantial changes than the first amendment, especially the introduction of merger control and the abolition of resale price maintenance arrangements for branded goods.

The *Third Act to Amend the Act against Restraints of Competition* of 1976[15] introduced, in particular, specific size criteria for press mergers. The *Fourth* and so far last *Act to Amend the Act against Restraints of Competition* of 1980,[16] finally aimed at removing some further gaps and deficiencies of the cartel law relating especially to merger control, abuse control over market dominating enterprises, and discrimination.

A *Fifth Amendment* (in Parliament in December 1989) again provides some - controversial - improvements in some parts of the law. Among the provided changes, however, one procedural amendment allowing in the future to use all procedural powers of the cartel authority in national proceedings also for proceedings of the European Commission seems to be generally welcomed.

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[12] BGB1. I. 1081.

[13] *Act to Amend the Act against Restraints of Competition* (Gesetz zur Anderung des Gesetzes gegen Wettbewerbsbeschrankungen) of September 15, 1965 (1965) BGB1. I 1363.

[14] *Second Act to Amend the Act against Restraints of Competition* (Zweites Gesetz zur Anderung des Gesetzes gegen Wettbewerbsbeschrankungen) of August 3, 1973 (1973) BGB1. I 917.

[15] *Third Act to Amend the Act against Restraints of Competition* (Drittes Gesetz zur Anderung des Gesetzes gegen Wettbewerbsbeschrankungen) of June 28, 1976 (1976) BGB1, I 1697.

[16] *Fourth Act to Amend the Act against Restraints of Competition* (Viertes Gesetz zur Anderung des Gesetzes gegen Wettbewerbsbeschrankungen) of April 26, 1980 (1980) BGB1. I 458.

5.0 HORIZONTAL AGREEMENTS

As to the present situation, the general prohibition of restrictive agreements among competitors - "horizontal agreements," cartels - in Section 1 of the *Act against Restraints of Competition* (ARC) is still one of the most important and effective substantive provisions of the law (Appendix A). An agreement violating Section 1 ARC is null and void. The prohibition covers not only restrictive agreements on territories and prices, but also on all other economic "parameters of action," e.g., such as research and development and advertising. It does not apply to restraints of actual competition but also of potential competition. The restrictive effect must not be actual: it is sufficient that the restriction is "likely" to affect the market. Furthermore, the restrictive effect must not be substantial: it is sufficient if it is perceptible. The restrictive agreement must be made by "enterprises," a term which is very broadly interpreted, covering any independent economic activity. A restrictive agreement void under Section 1 ARC is, of course, not enforceable. Attempts to enforce such void agreements may be punished by fines of up to DM 1 million or of up to three times the additional proceeds obtained because of the violation of the prohibition of cartels, Section 38(1) No. 1 in conjunction with Section 38(4) sentence 1 ARC. The Federal Cartel Office has in the last years stepped up its enforcement of the ban on cartels considerably, especially as regards bid-rigging, and imposed fines of many millions of DM for its violation; in one case in this year, fines imposed exceeded Dm 200 million.

The ban on restrictive agreements is supplemented by prohibitions of concerted action in Section 25(1) ARC and of restrictive recommendations in Section 38(1) No. 11 ARC. The rationale of both is to prevent the circumvention of the prohibition of cartels. "Concerted action" means in this context any meeting of minds short of an "agreement" in the sense of Section 1 ARC but going beyond conscious parallel conduct. "Recommendation" is a declaration of will conveying to the addressee the idea that a certain conduct is desirable and advantageous for him and should be adopted.

The ban on cartels in the ARC is not absolute. The law provides for exemptions from this prohibition for certain kinds of agreements which the legislator deemed to be beneficial or at least acceptable under certain conditions. Examples are rationalization cartels, Section 5(2), (3) ARC specialization cartels, Section 5 a ARC, cartels of small and medium-sized enterprises, Section 5 b ARC, and export cartels, Section 6 ARC. For very exceptional situations, i.e., if there is a structural crisis in a sector of the economy, Section 4 ARC, or if this is justified by important interests of the economy as a whole, Section 8 ARC, even sweeping exceptions would be permissible. Both possibilities last mentioned have played almost no role in practice.

6.0 VERTICAL AGREEMENTS

Another central prohibition of the ARC applies to restrictive vertical agreements as far as they restrain the freedom of one of the parties in regard to the content of transactions with third parties, Section 15 ARC (Appendix A). This rule covers, in particular, resale price maintenance systems. The law provides also for an exemption from the ban on restrictive vertical agreements, essentially for reasons of cultural policy, i.e., for publications for which resale price maintenance is lawful, Section 16 ARC. Vertical agreements in violation of Section 15 ARC are void and the attempt to enforce them is subject to the same sanctions as an attempt to enforce a void horizontal agreement, Section 38 (1) No. 1 in conjunction with Section 38(4) sentence 1 ARC.

Vertical agreements which restrict one of the parties in its freedom to use the supplied or other goods or services, or to purchase or sell other goods or services from respondents to third parties, or oblige one of the parties to accept goods or services not related to the subject-matter of the agreement by their nature or custom of the trade, are, on principle, allowed and only subject to an abuse control by cartel authorities, Section 18 ARC (Appendix A). In practice, this abuse control has played no great role so far. Use restrictions, exclusive dealing and distribution arrangements as well as tying arrangements, which may come under this provision, can however, be in violation of other provisions of the law, in particular the prohibition of discriminatory conduct, Section 26(2) and (3) ARC.

Vertical agreements relating to certain commercial property rights, in particular patents, and to qualified know how, are specifically regulated in Sections 20 and 21 ARC (Appendix A). These provisions have lost their practical importance since most of the more substantial transactions in this field are also governed by the insofar stricter EC rules.

7.0 ABUSE OF DOMINANT POSITION

Under Section 22 ARC, the cartel authority may prohibit certain practices or, where appropriate, invalidate contracts or agreements when a "market dominating" enterprise "abuse" its market dominating position (Appendix A). The purpose of this abuse control over market dominating enterprises is to prevent enterprises from taking advantage of their freedom of action which results from their market dominating position to the detriment of third parties. It is considered as "an indispensable instrument for limiting economic power on markets where competition no longer fulfills its control function adequately."[17] The text of Section 22 ARC has been modified several times to facilitate both the establishment of market domination as well as of "abuse."

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[17] See Bundestag Economic Committee, Report on the Draft of a Fourth Act to Amend the GWB, Bundestags-Drucksache 8/3690, p. 24.

Although the Federal Cartel Office had instituted many proceedings under Section 22 ARC in the first years, the number of such cases has drastically declined in the last time because of the very high standard of evidence set by the courts. Thus, while in earlier times the Office commenced more than a hundred proceedings in a year, in 1988 it recorded only two new cases under this provision. As this is unlikely to change, it appears fair to state that general abuse control over market dominating enterprises in the Federal Republic of Germany has not been and is not likely to become particularly effective.

In comparison to Section 22 ARC the far more important provisions on abuses of market power are those specifically addressing discriminatory conduct, and among them especially the general ban on discriminatory conduct in Section 26(2) ARC (Appendix A).

8.0 DISCRIMINATORY CONDUCT

Section 26(2) ARC provides that powerful enterprises may not discriminate against other enterprises. The market power of the enterprises which are addressees of Section 26(2) ARC may be "absolute" like that of market dominating enterprises in the meaning of Section 22 ARC or "relative" like that of lawful cartels, enterprises maintaining resale prices and, in particular, enterprises on which suppliers or purchasers depend to such an extent that they have no sufficient and reasonable possibility of dealing with other enterprises. The discriminatory conduct may consist of unfair hindrances of unjustified differential treatment. A general ban on discriminatory conduct was expressly ruled out by the legislator because of the great risk of substantial anticompetitive effects.[18]

The prohibition of discriminatory conduct is, among those also aiming at protecting the victims of antitrust violations, Section 35 ARC (Appendix A), in practice the most important. The vast majority of private antitrust suits are based on alleged violations of the prohibition of discriminations. A violation of the prohibition of discriminatory conduct may also be sanctioned by a fine, Section 38(1) No. 8 ARC.

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[18] Bundestag Economic Committee, Report on the Draft of a Fourth Act to Amend the GWB, Bundestags-Drucksache 8/3690, p. 29.

9.0 MERGERS

Under Section 24 ARC the Federal Cartel Office has to prohibit mergers which are likely to create or strengthen a marketing dominating position, unless the enterprises involved can prove that the benefits for competition resulting from the merger will outweigh the disadvantages (Appendix A). The mergers are only subject to control if the participating enterprises record a combined turnover of at least DM 500 million (Appendix A). At present, the merger provisions provide for two years of supervision of mergers; merger projects involving one enterprise with a turnover of at least DM 2,000 million or involving at least two enterprises with a turnover of DM 1,000 million each must be notified before they are consummated. Other merger projects may be notified in advance, but they may also be notified after completion.

Mergers which are prohibited by the Federal Cartel Office may be authorized by the Federal Minister of Economics, if the restraint of competition is outbalanced by advantages to the economy as a whole, or if the merger is justified by a predominating public interest. The Minister has used this possibility very rarely, although the last case was a particularly important one, i.e., the merger between Daimler-Benz and MBB.

By the end of 1988, a total of 9434 mergers were notified since the introduction of merger control. If these, 6303 were horizontal mergers, 1384 vertical, and 1747 conglomerate. So far, the Federal Cartel Office has prohibited 81 mergers.[19] The Office, however, takes the view that the effect of merger control to slow down concentration has been greater than this figure indicates. Owing to the development of administrative and court practice, enterprises have increasingly become able to judge for themselves whether a merger is within the prohibited area. Therefore, merger projects are abandoned before being notified to the Federal Cartel Office. In a number of other cases, merger projects were submitted for an information examination prior to notification. As a result of this, a number of projects were abandoned or modified.

So far, the EC law has had little impact on the enforcement of merger control in the Federal Republic of Germany. This is likely to change very considerably if the envisaged EC merger control regulation is adopted.

10.0 PRIVATE ENFORCEMENT

In principle, the protection of competition against restraints can be entrusted to private persons or to the state. In the Federal Republic of Germany, the law provides for both possibilities. Thus, the victim of a boycott or a discrimination can seek injunctive relief and sue for damages, Section 35

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[19] See Biannual Activity Report of the Federal Cartel Office 1987/1988, p. 115 f, 127.

ARC.[20] This possibility plays a certain role in practice, especially in discrimination cases. The main burden of defending competition, however, lies in the Federal Republic of Germany with the cartel authorities, especially the Federal Cartel Office. Cartel authorities may use under the ARC two types of procedure by instituting quasi-penal or administrative proceedings. Quasi-penal proceedings are used by the cartel authorities if a violation of a provision of the ARC occurs for which the law explicitly provides the possibility of sanctions by a fine. Examples would be attempts to enforce horizontal or vertical restrictive agreements, boycotts and discriminations. Administrative proceedings are used by the cartel authorities in all other cases, e.g., if there is an alleged abuse of a market dominating position, or if a merger, or merger project, appears to be anticompetitive, and prohibition orders are contemplated in such cases, or if a group of enterprises submits an application to allow an exemption from one of the prohibitions of the ARC, e.g., a rationalization cartel. For the purposes of both kinds of proceedings, the cartel authorities have wide powers of investigation. Thus, they may, e.g., not only require the submission of relevant information, Section 46 ARC (Appendix A), they may also, under circumstances, search the premises of enterprises and seize documents.[21] Furthermore, certain situations may lead to both kinds of proceedings. If, for instance, an enterprise in a market dominating position does not terminate a specific conduct prohibited by the cartel authority as abusive, the cartel authority may impose a fine for the violation of its prohibition order, Section 38(1) No. 4 ARC.

11.0 PUBLIC ENFORCEMENT

According to the law, and in practice, the most important cartel authority in the Federal Republic of Germany is the Federal Cartel Office, Section 48 ARC (Appendix A). To be emphasized is the almost court-like independence of this authority's quasi-tribunals which, in individual cases, are not subject to directions neither from the President of the Office, nor from the Minister of Economics, nor from any other person or institution.[22] The basic rule of jurisdiction provides that the Federal Cartel Office is empowered to deal with all restraints of competition having effects in more than one of the German states (Lander), Section 44 (1) No. 1 lit. d ARC (Appendix A). Beyond that, it has a number of exclusive responsibilities of which merger control is the most important one, Section 44(1) No. 1 lit. a to c, e ARC.

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[20] See Section 35 ARC (Appendix A).

[21] See e.g., Section 55 ARC.

[22] The Federal Minister of Economics may, however, give general directions which then have to be published in the Federal Legal Gazette, Section 49 ARC. This possibility has been used only very rarely.

The high degree of independence and the wide scope of responsibilities distinguishes the Federal Cartel Office from the state cartel authorities which are fully integrated in their respective ministerial hierarchies and which are only responsible for cases involving restraints of competition not causing effects beyond the area of the respective state, Section 44(1) No. 3 lit. d ARC. They do administer, however, the same law as the Federal Cartel Office, i.e., the Act Against Restraints of Competition, and they are not subject, according to the German federal system, to directions of any federal authority, including the Federal Cartel Office.

The Federal Minister of Economics has a limited number of responsibilities of his own in the area of antitrust administration, Section 44(1) No. 2 ARC. To be mentioned are the abuse control over pure export cartels, the authorization of "Minister" cartels, and, most important, the authorization of mergers prohibited by the Federal Cartel Office because of their anticompetitive effects for consideration of the economy as a whole and the public interest. From the very beginning and under different administrations, the Ministers have made very little use of these exceptional possibilities to take the initiative in competition matters.

A fourth institution to be mentioned in this context is the Monopolies Commission, Section 24 b ARC (Appendix A). This Commission is composed of five independent experts charged to analyze and, if necessary, criticize antitrust enforcement practice, especially as regards abuse control and merger control. Under the law, the Commission has to submit a report on these activities every two years. In addition, the Commission has to or may report on individual merger cases or other specific problems. Thus, essentially, the Commission fulfills a kind of independent "watchdog" function.

Last but certainly not least, the courts play a very important role in the protection of competition. All decisions of cartel authorities, irrespective of whether they have been taken in administrative or quasi-penal proceedings, are open to appeal to the Courts of Appeal, Sections 62 ff, 82 ARC. The courts have a full review of the cartel authority's decision on points of fact as well as of law. A decision of the Court of Appeals which does not satisfy a party, a defendant, or the cartel authority, may in most cases be further appealed on points of law to the Federal Supreme Court, Sections 73 and 83 ARC.

Appendix A

EXCERPTS FROM THE GERMAN ACT AGAINST RESTRAINTS OF COMPETITION (ARC)

Section 1 ARC reads:

(1) Agreements made for a common purpose by enterprises or associations of enterprises and decisions of associations of enterprises shall have no effect, insofar as they are likely to influence, by restraining competition, production or market conditions with respect to trade in goods or commercial services. This shall not apply insofar as this Act provides otherwise.

(2) The term "decision of an association of enterprises" shall include decisions of meetings of the members of a legal entity, insofar as its members are enterprises.

Section 15 ARC reads:

Agreements between enterprises concerning goods or commercial services relating to markets located within the area to which this Act applies shall be null and void, insofar as they restrict a party to them in its freedom to determine prices or terms of business in such contracts which it concludes with third parties in regard to the goods supplied, other goods, or commercial services.

Section 18 ARC reads:

(1) The cartel authority may declare agreements between enterprises concerning goods or commercial services to be of no effect either immediately or as from some future date to be determined by it, and prohibit the implementation of new, similar agreements, insofar as they

1. restrict one of the parties in its freedom to use supplied goods, other goods or commercial services, or
2. restrict one of the parties in the purchase of other goods or commercial services from, or their sale to, third parties, or
3. restrict one of the parties in the sale of the supplied goods to third parties, or
4. oblige one of the parties to accept goods or commercial services not related to the subject-matter of the agreements by their nature or the custom of the trade.

and insofar as

a) by such agreements a number of enterprises significant in relation to competition in the market are similarly bound and unfairly restricted in their freedom of competition, or
b) by such agreements market entry by other enterprises is unfairly restricted, or
c) by the extent of such restrictions competition in the market for these or other goods or commercial services is substantially impaired.

(2) A restriction which is significant in relation to the sources of supply and demand that are left open to other enterprises shall not be deemed unfair in the sense of subsection (1)(b).

Section 20 ARC reads:

(1) Agreements concerning the acquisition or use of patents, utility models, or protected seed varieties shall be of no effect insofar as they impose upon the acquirer or licensee any restrictions on his business conduct which go beyond the scope of the protected right; restrictions pertaining to the type, extent, quantity, territory or period of exercise of such right shall not be deemed to go beyond its scope.

(2) Subsection (1) shall not apply to

1. restrictions imposed upon the acquirer or licensee insofar and as long as they are justified by the seller's or licensor's interest in a technically satisfactory exploitation of the protected matter,
2. obligations of the acquirer or licensee with respect to the price to be charged for the protected article,

3. obligations of the acquirer or licensee to exchange experience or to grant licenses for improvements in, or applied uses of, an invention, insofar as these obligations are in accordance with identical obligations of the patentee or licensor,
4. obligations of the acquirer or licensee not to challenge the protected right,
5. obligations of the acquirer or licensee relating to the regulation of competition in markets outside the area to which this Act applies insofar as such restrictions do not remain in force beyond the expiration of the acquired or licensed right.

(3) Upon application, the cartel authority may authorize an agreement of the nature specified in subsection (1), if the freedom of economic action of the acquirer or licensee or other enterprises is not unfairly restricted, and if competition in the market is not substantially impaired by the extent of the restrictions involved. Section 11(3) to (5) shall apply as appropriate.

(4) Sections 1 to 14 shall remain unaffected.

Section 21 ARC reads:

(1) Section 20 shall apply as appropriate to agreements concerning the assignment or the exploitation of legally unprotected inventions, manufacturing processes, technical designs, other technological achievements, as well as legally unprotected advances in cultivation methods in the field of plant breeding, insofar as they constitute trade secrets.

(2) Section 20 shall apply as appropriate to agreements concerning seed of a variety appearing in the special varieties list (Sections 38 and 60 of the *Seed Trade Act* as published on June 23, 1975 (Federal Legal Gazette I, p. 1453), or registered in the Catalogue of Varieties (Sections 70 and 72 of the aforementioned Act) between a plant breeder and a seed multiplier or a seed multiplying enterprise.

Section 22 ARC reads:

(1) An enterprise is market dominating within the meaning of this Act insofar as, in its capacity as a supplier or buyer of a certain type of goods or commercial services,

1. it has no competitor or is not exposed to any substantial competition, or
2. it has a paramount market position in relation to its competitors; for this purpose in addition to its market share its financial strength, its access to the supply or sales markets, its links with other enterprises and the legal or factual barriers to the market entry of other enterprises shall in particular be taken into account.

(2) Two or more enterprises shall also be deemed market dominating insofar as, in regard to a certain type of goods or commercial services, no substantial competition exists between them, for factual reasons, either in general, or in specific markets, and they jointly meet the requirements of subsection (1).

(3) It shall be presumed that

1. an enterprise is market dominating within the meaning of subsection (1), if it has a market share of at least one-third for a certain type of goods or commercial services; this presumption shall not apply when the enterprise recorded a turnover of less than DM 250 million in the last completed business year;
2. the requirements specified in subsection (2) are met if, in regard to a certain type of goods or commercial services,
   a) three or less enterprises have a combined market share of 50 percent or over, or
   b) five or less enterprises have a combined market share of two-thirds or over;

this presumption shall not apply, insofar as enterprises are concerned which recorded turnovers of less than DM 100 million in the last completed business year. As regards the calculation of the market shares and turnovers, Section 23(1), sentences 2 to 10 shall apply as appropriate.

(4) In regard to market dominating enterprises, the cartel authority shall have the powers set out in subsection (5), insofar as these enterprises abuse their dominating position in the market for these or other goods or commercial services. An abuse within the meaning of sentence 1 is present, in particular, if a market dominating enterprise as a supplier or purchaser of a certain type of goods or commercial services

1. impairs the competitive possibilities of other enterprises in a manner relevant to competition on the market in the absence of facts justifying such behavior;
2. demands considerations or other business terms which deviate from those which would result in all probability if effective competition existed; in this context in particular the practices of enterprises on comparable markets characterised by effective competition have to be taken into account;
3. demands less favourable considerations or other business terms than are demanded from similar buyers on comparable markets by the market dominating enterprise, unless there are facts justifying the differentiation.

(5) If the requirements of subsection (4) are met the cartel authority may prohibit abusive practices by market dominating enterprises and declare agreements to be of no effect; Section 19 shall apply as appropriate. Prior to such action, the cartel authority shall request the parties involved to discontinue the abuse to which objection was raised.

(6) Insofar as the requirements of subsection (1) are met in regard to an affiliated company (Konzernunternehmen) within the meaning of Section 18 of the *Joint Stock Companies Act*, the cartel authority may use its powers under subsection (5) against each affiliated enterprise (Konzernunternehmen).

Section 23 ARC reads:

(1) The merging of enterprises shall be notified to the Federal Cartel Office without delay, if

1. within the total area to which this Act applies or in a substantial part thereof a market share of at least 20 percent is obtained or increased by the merger or if a participating enterprise has a share of at least 20 percent in another market, or
2. the participating enterprises together at some time during the completed business year preceding the merger had at least 10,000 employees or recorded a turnover of at least DM 500 million in this period.

If one of the participating enterprises is a controlled or controlling enterprise within the meaning of Section 17 of the *Joint Stock Companies Act* or an affiliated enterprise (Konzernunternehmen) within the meaning of Section 18 of that Act, the enterprises linked in this manner shall be regarded as a single enterprise for the calculation of market shares, number of employees and turnovers; if several enterprises as a result of an agreement or otherwise act together in such a way that they jointly are able to exercise a controlling influence on a participating enterprise, each of them shall be regarded as a controlling enterprise. Section 158(1) and (2) of the *Joint Stock Companies Act* shall apply as regards the calculation of the turnovers; turnovers concerning the supply of goods and services between enterprises which are linked within the meaning of sentence 2 (intra-group turnovers), value added tax as well as consumption taxes shall be left out of account; turnovers in a foreign currency shall be converted into Deutsche Mark at the official exchange rate. In the case of credit institutions and building and loan associations, one tenth of the total assets, and in the case of insurance enterprises, the premium income of the last completed business year shall substitute turnover. Amounts recorded as investments in affiliated enterprises as defined in sentence 2 shall be deducted from the balance sheet figure; premium income shall mean income from insurance and reinsurance business including amounts ceded to re-insurers. As regards enterprises whose operations wholly or partially consist of trade in goods, only three-fourths of the turnover shall be taken into account. As regards enterprises whose operations wholly or partially consist of publishing, producing or distributing newspapers or magazines or parts of them, twenty times the amount of the turnover shall be taken into account; sentence 6 remains unaffected. Where all or a substantial part of the assets of another enterprise are acquired, the calculation of the market share, number of employees and turnover of the selling enterprise shall take account of the sold assets only. Sentence 8 shall apply, as appropriate, to the acquisition of shares, insofar as less than 25 percent of the shares are retained by the seller and the merger does not meet the requirements set out in subsection (2) No. 2, sentence 3, and No. 5. If a person or an association of persons who is not an enterprise is entitled to the majority interest in an enterprise, he, she or it shall be deemed to be an enterprise for the purposes of this Act.

(2) The following transactions shall be deemed mergers within the meaning of this Act:

1. acquisition of all or of a substantial part of the assets of another enterprise by amalgamation, reconstruction or in any other way;
2. acquisition of shares in another enterprise, provided the shares alone or together with other shares already held by the acquiring enterprise
    a) amount to 25 percent of the voting capital of the other enterprise, or
    b) amount to 50 percent of the voting capital of the other enterprise, or
    c) secure the enterprise a majority interest within the meaning of Section 16(1) of the *Joint Stock Companies Act*.

The shares held by the acquiring enterprise shall include also the shares belonging to an affiliated enterprise within the meaning of subsection (1), sentence 2, or held by another enterprise for the account of one of these enterprises, and, if the owner of the enterprise is a sole proprietor, any other shares belonging to the owner. If several enterprises simultaneously or successively acquire shares in another enterprise to the extent above mentioned, this shall also be deemed a merger between the participating enterprises (joint venture) as regards the markets in which the other enterprise operates. The acquisition of shares shall also be deemed a merger, insofar as the acquirer obtains, by means of an agreement, charter, articles of association, or a decision, the legal position held in a joint-stock company by a shareholder holding more than 25 percent of the voting capital. Shares in an enterprise shall be equal to voting rights.

3. Agreements with another enterprise by which:
    a) a Konzern [enterprise] within the meaning of Section 18 of the *Joint Stock Companies Act* is formed or the group of affiliated enterprises (Konzernunternehmen) is enlarged, or
    b) the other enterprise undertakes to carry on its operations for the account of the enterprise or to transfer its profit wholly or partially to the enterprise, or
    c) the plant of the other enterprise or a substantial part thereof is leased or otherwise transferred to the enterprise.
4. Bringing about a situation where at least half the members of the supervisory boards, the boards of management, or any other managing bodies of enterprises consist of the same persons.
5. Any other combination of enterprises as a result of which one or several enterprises are able directly or indirectly to exercise a controlling influence on another enterprise.

(3) A merger shall also be presumed to occur if the participating enterprises are already combined as specified in subsection (2), except when such merger does not result in a substantial strengthening of the existing combination of enterprises. If a credit institution acquires shares in another enterprise, on its formation or when its capital is increased, or otherwise within the context of its business operations, for the purpose of selling them on the market, this shall not be deemed a merger as long as the credit institution does not exercise the voting rights attached to the shares and provided the sale is effected within one year; when an enterprise is established, exercise of voting rights at the first general meeting following the establishment shall not constitute a merger. If an enterprise participating in a merger is an affiliated enterprise within the meaning of subsection (1), sentence 2, the controlling enterprise as well as the enterprises by which the controlling enterprise is itself controlled shall be considered participants in the merger. If two or more enterprise merge, this shall also be deemed a merger of the enterprises controlled by them.

(4) Notification shall be effected by:

1. in the case of amalgamation or reconstruction, the owners of the acquiring or newly formed enterprise or their representatives, or, in the case of legal persons and partnerships, the persons designated as their representatives by law or by the charter of the association;
2. in other cases
    a) the owners of the enterprises participating in the merger, and
    b) where subsection (2), Nos. 1 and 2, applies, also the sellers or their representatives, or, in the case of legal persons and partnerships, by the persons designated as their representatives by law or by the character of the

association; where letter b) applies, subsection (3), sentence 3, shall apply as appropriate.

(5) The notification shall indicate the form of the merger. Furthermore it must include the following data regarding each participating enterprise:

1. firm name or other designation and location or establishment or registered seat;
2. type of business;
3. insofar as the requirements of subsection (1), sentence 1, are met, the market share including the basis of its calculation or estimate, the number of employees and the turnovers; in the case of credit institutions and building and loan associations, the total assets shall be stated instead of the turnover and, in the case of insurance companies, the premium income;
4. when shares in another enterprise are acquired (subsection (2) No. 2), the amount of the shareholding acquired and of the total shareholding owned in it.

If a participating enterprise is an affiliated enterprise within the meaning of subsection (1), sentence 2, the particulars required in sentence 2, Nos. 1 to 3 shall also be given for such affiliated enterprises, and the Konzern [enterprise's] relationships, and relationships with regard to dependency and participation of the affiliated enterprises shall be included in such particulars.

(6) The Federal Cartel Office may request each of the participating enterprises to supply information on market shares including the basis for their calculation or estimate as well as the turnover for a specific type of goods or commercial services which the enterprise recorded in the lasts business year ending before the merger. If a participating enterprise is an affiliated enterprise within the meaning of subsection (1), sentence 2, the Federal Cartel Office may also request such information regarding the affiliated enterprises; it may also request the information from the affiliated enterprises. Section 46(2), (5), and (9) shall apply as appropriate. The Federal Cartel Office shall set a reasonable time-limit for the furnishing of the information. The powers of the Federal Cartel Office under Section 46 shall remain unaffected.

Section 24 ARC reads:

(1) If it is likely that a market dominating position will be created or strengthened as a result of a merger, the cartel authority shall have the powers specified in the following provisions, unless the participating enterprises show that the merger will also lead to improvements in the conditions of competition and that these improvements will outweigh the disadvantages of market domination.

(2) If the requirements of subsection (1) are present, the Federal Cartel Office shall prohibit the merger. The Federal Cartel Office may prohibit a merger as soon as the merger project has come to its knowledge; consummated mergers may be prohibited by the Federal Cartel Office only within a one-year period from the receipt of the full notification under Section 23; Section 24a (2), sentence 2, Nos. 1 and 5 to 6 shall apply as appropriate. Prior to prohibition the supreme Land authorities in whose territory the participating enterprises are located shall be given an opportunity to present their views. If the Federal Cartel Office has taken the decision mentioned in sentence 1, it shall be unlawful to consummate the merger without the authorization of the Federal Minister of Economics, or to participate in the consummation of the merger; legal transactions in violation of this prohibition shall be of no effect; this shall not apply to agreements covering the amalgamation, reconstruction, integration or establishment of an enterprise and to agreements among enterprises within the meaning of Sections 291 and 292 of the *Joint Stock Companies Act*, once they have become legally effective by entry in the Commercial Register or the Co-operative Societies Register. A consummated merger which has been prohibited by the Federal Cartel Office shall be dissolved, unless the Federal Minister of Economics authorizes the merger.

(3) Upon application, the Federal Minister of Economics shall authorize the merger if, in the individual case, the restraint of competition is outbalanced by advantages to the economy as a whole resulting from the merger or if the merger is justified by a predominating public interest; in this respect the competitiveness of the participating enterprises in markets outside the area to which this Act applies shall also be taken into account. The authorization may only be given if the extent of the restraint of competition does not endanger the market economy system. The authorization may contain restrictions and requirements. However, these must not aim at

subjecting the participating enterprises to a continued control of their conduct. Section 22 shall remain unaffected.

(4) The application for an authorization of the merger shall be filed with the Federal Minister of Economics in writing within a one-month period. The period shall commence with the service of the decision taken by the Federal Cartel Office as defined in subsection (2), sentence 1; if the decision is appealed against within the period of time provided in Section 65(1), sentences 1 and 2, the period for the application for authorization shall run from the date when the decision taken by the Federal Cartel Office becomes final. The Federal Minister of Economics shall decide on the application within four months from the expiry of the period specified in sentences 1 and 2 for the application for authorization. Prior to the decision, the supreme Land authorities in whose territory the participating enterprises are located shall be given an opportunity to present their views.

(5) The Federal Minister of Economics may revoke the authorization, or modify it by ordering restrictions, or include requirements, if the participating enterprises violate a requirement attached to the authorization. The Federal Minister of Economics may withdraw the authorization, if the participating enterprises have obtained it by fraud, threats, bribery or by supplying information which was false or incomplete to a substantial extent.

(6) The dissolution of a consummated merger may also consist in the restraint of competition being eliminated by means other than restoring the former situation. The Federal Cartel Office shall order the measures necessary to dissolve the merger, if

1. its decision specified in subsection (2), sentence 1, has become final; and
2. if the participating enterprises had filed an application for authorization of the merger with the Federal Minister of Economics, the rejection of this application or, where subsection (5) applies, the revocation or withdrawal has become final.

In so doing, and while safeguarding the interests of third parties, it shall order such measures as will attain the desired goal with a minimum of expense and burden for those involved.

(7) To enforce its order the Federal Cartel Office may in particular:

1. by imposing a nonrecurring or recurring penalty payment of DM 10,000 to DM 1,000,000 require those under a duty to dissolve the merger to take the measures ordered without delay;
2. prohibit the exercise of voting rights attached to shares in one of the participating enterprises held by another participating enterprise or to be attributed to it, or make the exercise of the voting rights or the manner in which they are exercised conditional upon the authorization of the Federal Cartel Office;
3. declare agreements bringing about the merger of the nature specified in Section 23(2) Nos. 1 and 3 to be of no effect; this shall not apply to agreements covering the amalgamation, integration or establishment of an enterprise and to agreements among enterprises within the meaning of Sections 291 and 292 of the *Joint Stock Companies Act*, once they have become legally effective by entry in the Commercial Register or in the Co-operative Societies Register;
4. appoint a trustee who shall execute the necessary legal declarations on behalf of the enterprises obliged to dissolve the merger and take all necessary measures; in this respect it must be determined to what extent the rights of those involved will be suspended as long as the trusteeship is in effect; as regards the legal relationship between the trustee and the enterprise involved, Sections 664, 666 to 670 of the *Civil Code* shall apply as appropriate; the trustee may demand adequate compensation from the enterprise involved.

(8) Subsections (1) to (7) shall not apply:

1. if the participating enterprises recorded a combined turnover of less than DM 500 million in the last completed business year, or
2. if an enterprise which is not a controlled enterprise and in the last completed business year recorded a turnover of not more than DM 50 million affiliates itself to another enterprise, unless the one enterprise recorded a turnover of at least DM 5 million and the other a turnover of at least DM 1,000 million, or

3. insofar as a market is affected in which goods or commercial services have been offered for at least five years and which in the last calendar year had a turnover of less than DM 10 million.

Section 23(1) sentences 2 to 10 shall be applied regarding the calculation of the turnovers.

(9) Subsection (8) sentence 1 No. 2 shall not apply insofar as competition in the publication, production or distribution of newspapers or periodicals or parts of them is restricted within the meaning of subsection (1) as a result of the merger.

Section 24 a ARC reads:

(1) A merger project may be notified to the Federal Cartel Office. The project shall be notified to the Federal Cartel Office, if

1. one of the enterprises participating in the merger recorded a turnover of at least DM 2,000 million in the last completed business year, or
2. at least two of the enterprises participating in the merger recorded individual turnovers of DM 1,000 million or over in the last completed business year, or
3. the merger is to be effected under the law of a Land by legislation or any other governmental act.

As regards the notification, Section 23 shall apply as appropriate, save that when Section 23(1), sentence 1, No. 2 and subsection (6) is applied, for the date of the merger there shall be substituted the date of the notification, and that in the case of an amalgamation or reconstruction the owners, representatives, or persons appointed as representatives of the parties to the merger shall be obliged to file notification. The notification shall only be considered effective when the particulars specified in Section 23(5) are included. Section 46(9) shall apply as appropriate to the information and documents obtained in connection with the notification.

(2) If the merger project has been notified to it, the Federal Cartel Office may prohibit the merger only if it informs the person who has effected the notification that it has begun an examination of the merger project and if the decision under Section 24(2), sentence 1, is taken within a period of four months from receipt of the notification. The Federal Cartel Office may also prohibit the merger after the expiry of the four month period, if

1. the enterprises participating in the merger have agreed to an extension of time, or
2. the merger is consummated, although the one-month period specified in sentence 1 or, if the Federal Cartel Office has sent the communication referred to in sentence 1, the specified four-month period has not yet expire, or
3. the merger is consummated other than as notified, or
4. the merger has not yet been consummated and the conditions which caused the Federal Cartel Office to refrain from sending the communication referred to in sentence 1 or from prohibiting the merger under Section 24(2), sentence 1, have materially changed, or
5. the Federal Cartel Office has sent the communication referred to in sentence 1 or not prohibited the merger under Section 24(2), sentence 1, by reason of false or incomplete particulars having been supplied by the enterprises participating in the merger or by any other person, or
6. information under Section 23(6) or Section 46 was not supplied or not supplied in due time and this has caused the Federal Cartel Office to act as described in No. 5.

(3) The notification of the merger project shall not affect the obligation to notify the merger under Section 23; when notification under Section 23 is filed, reference may be made to the material submitted for the notification of the merger project.

(4) If a merger project has to be notified under subsection (1), sentence 2, it shall be unlawful either to consummate the merger prior to the expiry of the one-month period in subsection (2), sentence 1 and, if the Federal Cartel Office has sent the communication referred to in subsection (2), sentence 1, prior to the expiry of the specified four-month period or the extension of time agreed upon, or to participate in the consummation of the merger; except when the Federal Cartel Office, prior to the expiry of the periods mentioned in subsection (2) sentence 1 has informed the person in writing who has effected the notification that the merger project does not meet the requirements of prohibition set out in Section 24(1); legal transactions violating this

prohibition shall be of no effect; this shall not apply to agreements covering the amalgamation, reconstruction, integration or establishment of an enterprise and to agreements among enterprises within the meaning of Sections 291 and 292 of the *Joint Stock Companies Act*, once they have become enforceable by entry in the Commercial Register or in the Co-operative Societies Register.

Section 24 b ARC reads:

(1) A Monopolies Commission shall be established to issue regular opinions on the trend of business concentration in the Federal Republic of Germany and the application of Sections 22 to 24a. It shall consist of five members who must have special knowledge and expertise in the field of economics, business administration, social policy, technology or commercial law.

(2) The members of the Monopolies Commission must not be members either of the government or any legislative body of the Federal Republic or a Land or of the public service of the Federal Republic, a Land or any other public body, except as university teachers or staff members of a scientific institution. Furthermore, they must not be representatives of an economic association or of an employers' or employees' organization, or be employed with one of them under a regular employment contract or special service contract. Nor must they have held such a position during the year preceding their appointment to the Monopolies Commission.

(3) In its opinion, the Monopolies Commission shall assess the current state of business concentration and its foreseeable trends from the standpoint of economic policy, and in particular competition policy, and shall evaluate the application of Sections 22 to 24a. It shall also indicate such amendments to the relevant provisions of this Act as it may deem necessary.

(4) The Monopolies Commission shall only be bound by the terms of this Act and shall carry on its activity independently. If a minority holds dissenting views when an opinion is drafted, it may express them in the opinion.

(5) The Monopolies Commission shall issue every two years, by June 30, an opinion covering the situation which prevailed during the last two completed calendar years, and submit it immediately to the Federal Government, the first opinion being due on June 30, 1976. The opinions pursuant to sentence 1 shall immediately be submitted to the legislative bodies by the Federal Government and at the same time be published by the Monopolies Commission. Within a reasonable period the Federal Government shall present its views and comments on the opinions to the legislative bodies. The Monopolies Commission may give additional opinions as it deems appropriate. The Federal Government may instruct it to give additional opinions. The Monopolies Commission shall submit opinions pursuant to sentences 4 and 5 to the Federal Government and publish them. The Federal Minister for Economics has to request an opinion from the Monopolies Commission in particular cases which are submitted to him for decision under Section 24(3).

(6) The members of the Monopolies Commission shall be appointed by the President of the Federal Republic of Germany on a proposal by the Federal Government. One member shall retire from the Commission on July 1 of each year in which an opinion is to be issued under subsection (5), sentence 1. The sequence of retirement shall be determined by lot at the first meeting of the Monopolies Commission. On a proposal by the Federal Government, the President of the Federal Republic shall on each such occasion appoint one new member for a term of four years. Reappointments shall be permissible. The Federal Government shall hear the members of the Monopolies Commission before proposing new members. The members shall be entitled to resign their office by notice to the President of the Federal Republic. If a member retires prematurely, a new member shall be appointed for the term of office of the retiring member; sentences 4 to 6 shall apply as appropriate.

(7) Decisions of the Monopolies Commission shall require the agreement of at least three members. The Monopolies Commission shall elect its chairman from among its members. The Monopolies Commission shall establish its own rules of procedure.

(8) The Monopolies Commission shall have its own secretariat. The work of the secretariat shall comprise passing on and compiling source material, making technical preparations for meetings of the Monopolies Commission, printing and publishing the opinions as well as handling other administrative duties.

(9) The members of the Monopolies Commission and the staff of the secretariat shall be bound to secrecy as regards its discussions and discussion documents labelled as confidential by the Monopolies Commission. The secrecy requirement shall also cover information supplied to the Monopolies Commission and marked confidential.

(10) The members of the Monopolies Commission shall receive a lump-sum compensation and they shall be reimbursed their travelling expenses. These shall be determined by the Federal Minister of Economics in agreement with the Federal Minister of the Interior. The costs of the Monopolies Commission shall be borne by the Federal Republic.

Section 26 (2) ARC reads:

(2) Market dominating enterprises, associations of enterprises within the meaning of Sections 2 to 8, 99(2), Section 100(1) and (7), Sections 102 to 103, and enterprises fixing prices under Sections 16, 100(3), or Section 103(1), No. 3, shall not unfairly hinder, directly or indirectly, another enterprise in business activities which are usually open to similar enterprises, nor in the absence of facts justifying such differentiation treat such enterprise directly or indirectly in a manner different from the treatment accorded to similar enterprises. Sentence 1 shall also apply to enterprises and associations of enterprises, insofar as suppliers or purchasers of a certain type of goods or commercial services depend on them to such an extent that sufficient and reasonable possibilities of dealing with other enterprises do not exist. For the prohibition procedure pursuant to Section 37a(2) a supplier of a certain type of goods or commercial services shall be presumed to depend on a purchaser within the meaning of sentence 2, if, in addition to the price reductions or other considerations customary in the trade, that purchaser regularly obtains special benefits not granted to similar purchasers.

Section 35 ARC reads:

(1) Any person who wilfully or negligently contravenes any provision of this Act or any decision issued under this Act by the cartel authority or the court of appeals shall, if such provision or decision is intended to protect another person, be liable to compensate such other person for any damage caused by such contravention. If a decision issued under Section 27 has been contravened, the injured party may also demand equitable compensation in money for any non-pecuniary damage.

(2) Any person who wilfully or negligently contravenes any decision issued by the cartel authority or the court of appeals within the meaning of subsection (1) shall, if the decision or determination pursuant to Section 70(3) becomes final, also compensate for any damage suffered from the date of service of the decision.

(3) In cases within subsection (1), an action for injunction may also be instituted by associations for the promotion of industrial interests, provided that the associations have legal capacity to sue in civil cases.

Section 44 ARC reads:

(1) The duties and powers assigned to the cartel authority by this Act shall be exercised:

1. The Federal Cartel Office (Section 48)
    - (a) with regards to cartels within the meaning of Sections 4, 6 and 7, insofar as these duties and powers have not been assigned to the Federal Minister of Economics;
    - (b) with regard to agreements of the nature specified in Section 16 and recommendations of the nature specified in Section 38a;
    - (c) with regard to mergers under Sections 23 to 24a, insofar as these duties and powers have not been assigned to the Federal Minister of Economics;
    - (d) if the effects of the influence on the market, or of the restrictive or discriminatory conduct, or of a competition rule extend beyond the territory of a Land;
    - (e) with regard to the Federal Postal Administration and the Federal Railways;
2. by the Federal Minister of Economics in cases of Sections 8 and 12(2) in conjunction with Section 6(1), and 24(1) in conjunction with (3) to (5);

3. in all other cases by the supreme Land authority as determined by the laws of the Land concerned.

(2) Insofar as an administrative fine under this Act is to be imposed on insurance enterprises, building and loan associations, enterprises engaged in banking or savings bank transactions, or associations of such enterprises, the cartel authority shall issue the decision imposing a fine in agreement with the competent supervisory authority. If agreement cannot be reached, the cartel authority shall submit the case to the Federal Minister of Economics whose instructions shall then replace such agreement. In cases where the cartel authority as well as the competent supervisory authority are Land authorities and agreement between them cannot be reached, the authority competent under the laws of the Land shall decide.

Section 46 ARC reads:

(1) Insofar as is necessary to carry out its duties under this Act, the cartel authority may:

1. request from enterprises and associations of enterprises information about their economic relationships;
2. inspect and examine business documents on the premises of enterprises and associations of enterprises during normal business hours;
3. request information from business and professional associations about their charters, their decisions, and the number and names of the members affected by the decisions.

(2) The owners of enterprises or their representatives, or, in the case of legal persons, partnerships and associations having no legal capacity, the persons designated as representatives by law, charter or articles of association as well as the representatives appointed pursuant to Section 36(2), shall furnish the requested information, submit business documents, and permit examination of these documents as well as entry into the offices and business premises.

(3) Persons entrusted by the cartel authority with carrying out examinations may enter the offices of enterprises and associations of enterprises. The basic right under Section 13 of the Basic Law is hereby limited to that extent.

(4) Searches may only be carried out pursuant to an order of the local judge (Amtsrichter) who has jurisdiction at the place where the search is to be made, Sections 306 to 310 and 311a of the *Code of Criminal Procedure* shall apply, as appropriate, to appeals from such an order. If there is danger in delay, the persons described in subsection (3) may carry out the necessary searches during business hours without judicial order. A record concerning such search shall be made on the spot, showing the essential results of the search and, in case no judicial order was issued, also the facts which had led to the assumption that there would be danger in delay.

(5) The person who is required to furnish information may refuse to answer questions the answer to which would expose him or one of his relatives as specified in Section 383(1) Nos. 1 to 3, of the *Code of Civil Procedure* to the danger of criminal prosecution or to proceedings under the *Act on Administrative Offenses*.

(6) Requests for information issued by the Federal Minister of Economics or the supreme Land authority shall be made by written individual order, those from the Federal Cartel Office by decision. The legal basis, the subject matter, and the purpose of the request shall be stated therein and an appropriate time limit shall be fixed.

(7) Verification shall be ordered by the Federal Minister of Economics or the supreme Land authority by written individual order, and by the Federal Cartel Office by a decision made with the consent of its President. The time, the legal basis, the subject matter, and the purpose of the verification shall be stated in the order or decision.

(8) Repealed

(9) The knowledge and documents obtained through any information supplied pursuant to subsection (1) Nos. 1 and 3, or through measures pursuant to subsection (1) No. 2 may not be used in tax assessment proceedings, including proceedings involving tax offenses, or in proceedings for exchange control offenses. The provisions of Sections 175, 179, 188(1), and 189 of the *Reich Tax Code of 22 May 1931* (legal Gazette of the Reich I, p. 161), concerning the obligation to assist and report to the tax offices, shall not apply to that extent.

Section 48 ARC reads:

(1) A Federal Cartel Office shall be established in Berlin as an independent higher federal authority. It shall be responsible to the Federal Minister of Economics.

(2) Decisions of the Federal Cartel Office shall be made by decision divisions which shall be established in accordance with instructions to be issued by the Federal Minister of Economics. Otherwise the President shall determine the distribution and handling of business in the Federal Cartel Office by rules of procedure requiring confirmation by the Federal Minister of Economics.

(3) The decisions of the decision divisions shall be made by a chairman and two other members.

(4) The chairmen and the other members of the decision divisions must be civil servant appointed for life. They must be qualified for holding judicial office or for senior rank in the civil service; the chairmen shall, as a rule, be qualified for holding judicial office.

(5) The members of the Federal Cartel Office must not be owners, chairmen, or members of the board of management or the supervisory board, of any enterprise, cartel, or business or professional association.

Chapter 30

ANTITRUST IN THE UNITED STATES AND CANADA: A SPECIAL RELATIONSHIP

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In this paper I address a particular aspect of the U.S. antitrust experience: the experience we have shared with Canada in the antitrust area. The centenary of the competition policies of both Canada and the U.S. only one year apart makes an apt point at which to reflect on where we have been and where we are going together.

It strikes me that something that can only be described as a "special relationship" exists -- and has for many years existed -- between Canada and the United States in the field of antitrust. To be sure, our two countries are not unique in the fact that we talk across borders about competition policy as the OECD Committee on Competition Law and Policy makes clear. It consists of heads or senior officials of most of the developed world's antitrust agencies. Its importance as a forum for cross-fertilization of ideas and for the forging of bonds of cooperation in the globally interdependent world of competition policy is evident.

Nor is the fact that Canada and the United States deal with one another bilaterally on antitrust matters unique. The Antitrust Division of the Department of Justice and our Federal Trade Commission maintain close ties with their counterparts in many countries, and have established traditions of friendship and cooperation with colleagues around the world. We have had antitrust cooperation agreements in place with West Germany since 1976[1] and with Australia since 1982;[2] we have annual exchanges of views and information with the antitrust authorities of the European Communities and of Japan; and we have strong relationships arising from common concerns and cemented by friendship with others. Our Canadian counterparts maintain similar ties.

Nonetheless, the antitrust relationship between Canada and the United States is a very special one. It has a uniquely long and rich history -- although no account of that history would be complete without noting that in earlier years much of it arose from arguments about "extraterritoriality." One of those early disagreements gave us the first antitrust-inspired blocking law, when in 1947 the province of Ontario responded to a U.S. antitrust investigation into the pulp and paper industry by enacting its *Business Records Protection Act*[3] -- saying to the U.S. Justice Department that Ontario is where we would like those records to stay, thank you. If we were to catalogue the more contentious episodes in our common antitrust history, we would have to note the *Canadian Radio Patents* cases in the late 1950s.[4] And whatever one's view of the merits of the dispute, none who were involved would wish to relive the rancor between our governments that grew from the *Uranium* cases of a decade ago.[5]

But it isn't the occurrence of these disputes that has made the relationship between us a special one, but the constructive dialogue that has emerged from them. Out of the experience of these differences, the United States and Canada have been in the vanguard in developing ways to cooperate in the antitrust field. The 1959 Fulton-Rogers Understanding,[6] which grew directly out of the *Canadian Radio Patents* episode, was the first agreement between governments to notify and consult on antitrust matters that could affect the other's interests. And, it was the Fulton-Rogers Understanding that inspired the first multilateral arrangement for antitrust notification and consultation, the 1967 OECD Council Recommendation Concerning Cooperation Between Member Countries on Restrictive Business Practices

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[1] Agreement Relating to Mutual Cooperation Regarding Restrictive Business Practices, June 23, 1976, United States-FederalRepublic of Germany, 27 U.S.T. 1956, T.I.A.S. No. 8291, reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,501.

[2] Agreement Relating to Cooperation on Antitrust Matters, June 29, 1982, United States-Australia, T.I.A.S. No. 10365, reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,502.

[3] *Business Records Protection Act*, R.S.O., c. 54.

[4] *United States v. General Electric Company, Westinghouse Electric Company, N.V. Philips*, [1962] Trade Cases (CCH) ¶¶\70,342; 70,428; 70,546.

[5] See, e.g., *In re Uranium Litigation*, 617 F.2d. 1248 (7th\Cir. 1980).

[6] House of Commons *Debates*, 1959, Vol. 1, pp. 617-619.

Affecting International Trade.[7] The notification and consultation provisions in the OECD Recommendation were more detailed and extensive than those in the Fulton-Rogers Understanding; and in the 1969 Mitchell-Basford Understanding.[8] The United States and Canada became the first countries to commit themselves to implement the Recommendation.

Then in 1984 our governments built on their experience with the Recommendation and the lessons of the *Uranium* dispute and entered into a far more detailed understanding resulting in the 1984 "Memorandum of Understanding... as to Notification, Consultation and Cooperation with Respect to the Application of National Antitrust Laws" -- or the "MOU," as it has come to be called.[9] And when the OECD Recommendation was revised in 1986,[10] the MOU was the source of much of the new material that was incorporated in it.

But it is not just the procedural arrangements our governments have pioneered that make the antitrust relationship a unique one. To a much greater extent, this special relationship is a reflection, a necessary outgrowth, of more fundamental connections between our nations. The volume of goods and services we sell to one another, the number of mergers involving firms with both Canadian and U.S. operations, and the many other ways in which our markets are integrated, mean that competition policy on one side of the border cannot help but have implications for competition policy on the other side.

If our national economic lives have been intertwined since we looked up and found ourselves sharing the same continent, certainly that will be so to an even greater extent under the Free Trade Agreement that entered into force at the beginning of 1989.[11] The closer we come to creating a true North American market, the more anomalous divergences between our competition policies will seem.

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[7] Recommendation of the Council Concerning Cooperation Between Member Countries on Restrictive Business Practices Affecting International Trade, OECD Doc. C(67)53 (Final) (October 5, 1967).

[8] Statement of Cooperation Between United States and Canada on Anti-Combines and Antitrust Matters, House of Commons *Debates*, 1969, Vol. 1, Appendix A.

[9] Memorandum of Understanding as to Notification, Consultation and Cooperation with Respect to the Application of National Antitrust Laws, Mar. 9, 1984, United States-Canada, reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,503.

[10] Revised Recommendation of the Council Concerning Cooperation Between Member Countries on Restrictive Business Practices Affecting International Trade, OECD Doc. C(86)44 (Final) (May 21, 1986).

[11] U.S.-Canada Free Trade Agreement, reprinted in 27 *International Legal Materials* 281 (1988).

Happily, it seems that our competition policies are not diverging. On the contrary, our competition policies have converged to a notable extent in recent years. Most significantly, the merger provisions in the new Competition Act[12] call for a competitive analysis that is remarkably similar to that in our own Merger Guidelines.[13] And the influence of modern economics in shaping our enforcement policies and interpreting our laws has been felt in both countries.

Now, what has all this meant in practice? How does this "special relationship" come into play? Let me give you some examples. On the nuts and bolts level, it means that we talk to each other frequently. The need for cross-border information gathering (and let me emphasize that this occurs in both directions), the number of occasions on which we find ourselves looking at the same conduct or the same merger, the frequency with which one side's antitrust people share their expertise in an industry the other side is inquiring into, the possibility that one side may have experience with procedures or methods of analysis in which the other is interested -- all these factors mean that our people are in contact regularly.

Nowhere has there been both the occasion and the need for this kind of cooperation as much as in the merger area. With the passage of the *Competition Act* in 1986, Canadian antitrust enforcers jumped into the merger waters with both feet[14] -- and not surprisingly, since then we and they have often found ourselves swimming in the same pool. Let me leave this metaphor before I drown in it, and simply make the obvious point: there are opportunities in this situation to be of significant help to each other in our efforts to reach a sound judgment about a merger's likely effect on competition, and to secure appropriate remedies when we conclude the effect will be an anticompetitive one.

I will give you one example, a transaction in which the actions both governments' antitrust agencies ultimately took are known: the proposed combination of the North American electric power transmission and generation businesses of Westinghouse and Asea Brown Boveri. The companies had plants and sold in both Canada and the United States, and after investigation both governments' antitrust agencies concluded that without appropriate relief the transaction would have anticompetitive effects in the the market for power transformers. Both agencies resolved their concerns through consent decrees. The U.S. decree calls for divestiture of a transformer plant in the United States.[15] The very novel Canadian decree relieves the parties of an obligation to divest a Canadian plant if they successfully persuade the relevant Canadian authorities to reduce transformer tariffs -- an alternative that would allow increased import competition to make up for the loss of competition between the rival domestic producers.[16]

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[12] R.S.C., 1985, c. C-34, as amended, § 91 *et seq.*. See Director of Investigation and Research's *Merger Enforcement Guidelines*, Bureau of Competition Policy Information Bulletin No. 5 (Ottawa: Minister of Supply and Services Canada, March 1991).

[13] U.S. Department of Justice Merger Guidelines (June 14, 1984), reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,103. A comparison of Canada's and the U.S.'s guidelines can be found in J.W. Rowley, "Summary Comparison of Draft Canadian Merger Guidelines and U.S. Department of Justice Merger Guidelines," *Canadian Competition Policy Record*, Vol. 11(4), 1990, pp. 86-94.

[14] The volume of activity is described in *Canadian Competition Policy Record*, Vol. 12(1), 1991, pp. 7-9.

I haven't described this case in order to indicate the outcome was the result of collusion between Canadian and American antitrust authorities. Obviously, each agency reached its own conclusion about how its law should be applied to the transaction. I cite it, however, as an example of the kind of transaction in which the sharing of information and analyses about markets, relief alternatives, and timing could have been -- and were -- of help to both countries' enforcement agencies. (Let me hasten to add that both agencies are and have been scrupulous in these situations about adhering to the confidentiality provisions in our respective merger laws.)

The main value of reviewing the past is to build on it for the future. Where do we go from here? The direction in which we should be moving is obvious enough: we should be working toward better cooperation, better coordination, and better efforts at harmonization. That is the direction that will secure for us the most soundly interpreted, and soundly applied, competition policy in North America, and that will provide the greatest benefits to North American businesses and consumers. That is the direction toward which I am prepared to work.

There are opportunities for improvement. One is in the area of getting the information we need to analyze markets and uncover anticompetitive conduct in an economic environment that increasingly extends beyond national borders. Here an important step has already been taken that, I hope, will come to fruition before long. In 1985, Prime Minister Mulroney and former President Reagan signed a Treaty on Mutual Assistance in Criminal Matters[17] that will provide enhanced means for each government to assist the other in criminal investigations and prosecutions. In both Canada and the United States, criminal enforcement is of course an important part of the antitrust picture, and the Mutual Assistance Treaty -- when it is ratified[18] -- will be available for use in connection with antitrust offenses just as it will be for

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15. *United States v. Westinghouse Electric Corp., ABB Asea Brown Boveri Ltd., and Asea Brown Boveri Inc.*, [1989-1] Trade Cases (CCH) ¶ 68, 607.

16. *Director of Investigation and Research v. Asea Brown Boveri, Inc., et al.*, CT-89/1, Consent Order dated June 15, 1989.

17. Treaty Between the Government of the United States of America and the Government of Canada on Mutual Legal Assistance in Criminal Matters, March 18, 1985, reprinted in 24 *International Legal Materials* 1092 (1985).

18. The treaty was ratified by the United States Senate on October 24, 1989.

other violations of either country's criminal laws. The Treaty will permit each side to use its investigative powers in aid of the other's proceedings, overcoming obstacles both sides now face because of limitations in the reach of domestic law and jurisdictional sensitivities. When these powers become available, North America will become an even more dangerous place for bid riggers and price fixers.

There are other opportunities. It is widely known that when the Free Trade Agreement (FTA) was being negotiated, one possibility that was studied was replacing antidumping rules in U.S. - Canada trade with enhanced enforcement of the two countries' antitrust provisions on predatory pricing.[19] The rationale, of course, was the argument that there would be no need for special non-antitrust rules to deal with cross-border price discrimination or below-cost selling, once the border no longer represented a barrier to trade and investment. A working group that included experts from each government in trade and antitrust law began to explore how such a regime might work; but in the FTA as it ultimately was adopted, the idea was set aside in favor of the interim binational appeals panel that is now in place to review dumping cases.

The FTA calls for the establishment of a working group to develop recommendations on permanent rules to deal with unfair pricing.[20] Whether such a working group will reconsider relying solely on antitrust concepts is something I cannot predict. I note, however, that Australia and New Zealand have recently adopted a regime of that sort in the framework of their free trade arrangement. Their experience is bound to be instructive when our Canadian and American experts focus on these issues again. And whatever emerges in the specific context of these FTA provisions, the discussion they stimulated on how to make our antitrust regimes mesh better is bound to bear fruit in the long run.

Indeed, there is an important step that can be taken now to take advantage of the combined strength and experience of the U.S. and Canadian antitrust systems and build on them. I have described the myriad connections our agencies have that form part of what I characterized as our "special relationship." But there is an irony in this relationship. Our systems have been sufficiently transparent and accessible to each other that we have tended sometimes to neglect the overview: the regular and systematic bilateral policy level review of developments and experiences that cements the relationship and generates initiatives to improve it.

The idea of initiating regular meetings of this kind has been talked about over the years among the Antitrust Division, our Federal Trade Commission, and the Bureau of Competition Policy. I have discussed it with my colleague Janet Steiger, Chairman of the FTC, and with Calvin Goldman and Howard Wetston of the Bureau of Competition Policy,[21] and am pleased to say that as soon as it can be arranged, our agencies will hold the first of what will be annual reviews of North American competition policy, at a government-to-government, enforcement agency to enforcement agency level. I am so enthusiastic at the prospect of this review, and of what I believe can be accomplished in this area, that I am prepared to depart from what I am told is the tradition of holding bilateral meetings in Washington during winter and Ottawa during summer, and to travel to Ottawa for the first meeting this winter.

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[19] On April 18, 1990 the Director of Investigation and Research circulated for comment his draft enforcement policy concerning predatory pricing under S.50(1)(c) of the *Competition Act*. See *Canadian Competition Policy Record*, Vol. 11(2), 1990, pp. 9-13.

[20] U.S.-Canada Free Trade Agreement, *supra* note 11, Article 1907.

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[21] At the end of October 1989 Mr. Goldman resigned as Director of Investigation and Research and was replaced by Howard Wetston.

Chapter 31

PRIVATE ENFORCEMENT OF CANADIAN COMPETITION LAW

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1.0 INTRODUCTION

The regulation of competition in Canada under the *Competition Act*,[1] ("the Act") contemplates a combination of public and private enforcement mechanisms. On the public side are the criminal offences in Part VI, injunctive relief or prohibition order that can be sought by the Attorney General pursuant to sections 33 and 34 of the Act and applications by the Director of Investigation and Research ("Director") to the Competition Tribunal in respect of the reviewable transactions contained in Part VIII. Private litigants are able to bring civil actions to recover damages pursuant to section 36 of the Act.

Prior to 1976, there was no statutory cause of action in Canadian law giving rise to a civil damages claim for breach of any of the provisions of the *Combines Investigation Act*.[2] On January 1, 1976, section 31.1 was added to the legislation which, in its present form as subsection 36(1) of the *Competition Act*, provides as follows:

> 36(1) Any person who has suffered loss or damage as a result of
> (a) conduct that is contrary to any provision of Part VI, or
> (b) the failure of any person to comply with an order of the Tribunal or other court under this Act,

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[1] R.S.C. 1985, c. C-34, as amended.

[2] R.S.C. 1970, c. C-23, as amended. Generally, see Gordon Kaiser, "The Stage I Amendments: An Overview" in J.R.S. Prichard et al. (eds.) *Canadian Competition Policy: Essays in Law and Economics* (Toronto: Butterworths, 1979), pp. 25-54.

> may, in any court of competent jurisdiction, sue for and recover from the person who engaged in the conduct or failed to comply with the order an amount equal to the loss or damage proved to have been suffered by him, together with any additional amount that the court may allow not exceeding the full cost to him of any investigation in connection with the matter and of proceedings under this section.

To succeed with an action brought pursuant to section 36, the plaintiff must establish that the defendant's conduct has been contrary to a Court Order granted under the Act, or to an Order granted by the Competition Tribunal (which is itself a criminal offence pursuant to section 74) or to the provisions of Part VI of the Act. Part VI contains the substantive criminal offences in the legislation and prohibits the following types of conduct:

- conspiracy (s. 45 and 46);
- bid rigging (s. 47);
- prohibited banking arrangements (s. 48);
- price discrimination and predatory pricing (s. 50);
- disproportionate promotional allowances (s. 51);
- misleading advertising or testimonials (s. 52 and 53);
- double ticketing (s. 54);
- pyramid or referral selling (s. 55 and 56);
- bait and switch selling or selling above advertised prices (s. 57 and 58);
- illegal promotional contests (s. 59); and
- resale price maintenance (s. 61).

2.0 CONSTITUTIONAL VALIDITY

Since its enactment, the constitutional validity of section 36 has been an area of great uncertainty and considerable analysis. Much of this debate has become academic by virtue of the Supreme Court of Canada's decisions in *General Motors of Canada Limited v. City National Leasing*[3] and *Quebec Ready Mix Inc. v. Rocois Construction Ltd.*[4] upholding section 36 as *intra vires* Parliament under subsection 91(2) of the *Constitution Act, 1867* pursuant to the general power to regulate trade and commerce.

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[3] (1989), 93 N.R. 326; generally, see Douglas Rutherford and John S. Tyhurst, "Competition Law and the Constitution: 1889-1989 and into the Twenty-first Century" in R.S. Khemani and W.T. Stanbury (eds.) *Historical Perspectives on Canadian Competition Policy* (Halifax: Institute for Research on Public Policy).

[4] (1989), 93 N.R. 388.

3.0 PROCEDURAL AND EVIDENTIARY CONSIDERATIONS

3.1 Limitation Periods

The limitation period for commencing an action under subsection 36(1) of the Act is prescribed in subsection 36(4) as two years from the later of the day that the conduct occurred or the day that any criminal proceedings relating thereto were finally disposed of:

> 36(4) No action may be brought under subsection (1),
>
> (a) in the case of an action based on conduct that is contrary to any provision of Part VI, after two years from
> (i) a day on which the conduct was engaged in, or
> (ii) the day on which any criminal proceedings relating thereto were finally disposed of,
> whichever is the later; and
>
> (b) in the case of an action based on the failure of any person to comply with an order of the Tribunal or other court, after two years from
> (i) a day on which the order of the Tribunal or court was violated, or
> (ii) the day on which any criminal proceedings relating thereto were finally disposed of,
> whichever is the later.

Given the length of time that criminal proceedings under the legislation may take through to final resolution, the limitation period for such actions is potentially very long indeed. However, if a matter is the subject of an investigation but no formal prosecution has been commenced, it would be advisable to commence the action within two years of the conduct in question even if same was not immediately actively pursued.

3.2 Choice of Forum

Actions pursuant to section 36 can be brought in provincial superior and small claims courts. In addition, subsection 36(3) of the Act provides that the Federal Court of Canada is a court of competent jurisdiction for an action under subsection 36(1). The constitutionality of this provison was upheld by the Supreme Court of Canada in *Rocois*, as noted above.

What does one consider when deciding whether to commence an action in the Federal Court rather than a provincial superior court? There are significant procedural differences, for example, there are different rules that govern the production of documents depending upon the forum in which the action is brought. If the action is brought in the Federal Court, production of documents, at least at the outset, is limited by Rule 447 to those documents that assist the party in establishing its case, or in rebutting its opponent's case. This is much narrower than the broad rules requiring production of all relevant documents in most provincial superior courts.

A further consideration is that it is probably not possible to couple an action in the Federal Court based on section 36 with a related or alternate claim for common law relief. In *Rocois*,[5] the Supreme Court of Canada upheld MacGuigan, J.A.'s judgment in the Federal Court of Appeal[6] which held that the Federal Court had no jurisdiction to decide the portion of the claim based on article 1053 of the *Civil Code* and that the Federal Court's jurisdiction was limited "with respect to proceedings brought under existing and applicable federal law." In *Industrial Milk Producers Association et al v. British Columbia Milk Board*,[7] Reed, J. agreed, albeit in *obiter*, that an action was not within the jurisdiction of the Federal Court to the extent that it was based on tortious conspiracy. This may limit the remedies available in such actions.

For these reasons, it is anticipated that most actions may tend to be brought in provincial superior courts, rather than in the Federal Court.

3.3 Use of the "Record of Proceedings"

Subsection 36(2) of the Act provides some evidentiary assistance to plaintiffs bringing a civil action against a defendant who has been convicted under the Act:

> 36(2) In any action under subsection (1) against a person, the record of proceedings in any court in which that person was convicted of an offence under Part VI or convicted of or punished for failure to comply with an order of the Tribunal or other court under this Act is, in the absence of any evidence to the contrary, proof that the person against whom the action is brought engaged in conduct that was contrary to a provision of Part VI or failed to comply with an order of the Tribunal or other court under this Act, as the case may be, and any evidence given in those proceedings as to the effect of those acts or omissions on the person bringing the action is evidence thereof in the action.

The "record of proceedings" is proof of liability unless the defendant presents evidence to the contrary. Further, the "record" does not appear to be limited to the charge and judgment but includes the evidence admitted in the initial action. However, it is not clear what impact, if any, this section has in subsequent civil litigation where the defendant presents "some" evidence to the contrary.

Depending upon the jurisdiction in which the action is brought, a plaintiff may be able to utilize the statutory provisions contained in some provincial evidence legislation, such as section 27 of the *Alberta Evidence Act*,[8] or sections 80 and 81 of the British Columbia *Evidence Act*,[9] which permit the introduction of a prior criminal conviction as *prima facie* evidence in a subsequent civil action. Further, plaintiffs should consider whether doctrines of issue estoppel and abuse of process may be available in the circumstances and perhaps of even greater assistance than subsection 36(2). For a good discussion of the law in this regard, see Herman and Hayden.[10]

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[5] (1989) 93 N.R. 388 at p. 394.

[6] [1985] 2 F.C. 40 at p. 55.

[7] (1988), 47 D.L.R. (4th) 710 (F.C.T.D.).

[8] R.S.A. 1980, c. A-21, as amended.

These principles were extended in *Saskatoon Credit Union Ltd. v. Central Park Enterprises Ltd.*[11] and *Bjarnarson v. Government of Manitoba*.[12] In both cases, the plaintiffs' applications to strike the defendants' Statements of Defence were granted where the defences sought to relitigate issues decided against the defendants in prior civil actions to which the plaintiffs were not a party.

The doctrine of abuse of process was applied in *Conroy Electronics Inc. v. Webster*[13] where the plaintiff had been convicted of misleading advertising contrary to Act with respect to the ability of its "Rustbuster" device to reduce corrosion. The defendant's application for summary judgment dismissing the plaintiff's defamation action on the grounds that it constituted an abuse of process was granted.

In view of the expense involved in relation to many such actions, it is anticipated that when criminal proceedings have been initiated or are contemplated, plaintiffs will often elect to await the outcome of same.

The evidentiary assistance that arises in a civil damages action by virtue of a prior criminal conviction will likely be a factor that an accused in criminal proceedings will take into account when considering whether to enter a guilty plea even if a favourable bargain on sentencing can be negotiated. This is also likely to increase the desirability of an accused agreeing to a consent prohibition order without a conviction pursuant to subsection 34(2) rather than after conviction pursuant to subsection 34(1). However, such parties should still consider the extent to which any information contained in the Agreed Statement of Facts that is often utilized in these proceedings could be utilized against them in a subsequent civil action.

3.4 Burden of Proof

Conviction of an offence or the institution of proceedings are not prerequisites to civil liability under subsection 36(1) of the Act: *Eli Lilly and*

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[9] R.S.B.C. 1979, c. 116, as amended.

[10] Michael Herman and Gerald Hayden, Jr., "Issue Estoppel: Mutality of Parties Reconsidered" (1986), 64 *Canadian Bar Review* 437.

[11] (1988), 47 D.L.R. (4th) 431 (B.C.S.C.).

[12] (1987), 48 Man. R. (2d) 149 (Q.B.).

[13] (1983), 33 C.P.C. (2d) 279 (Ont. H.C.).

Co. v. Marzone Chemicals Ltd..[14] Further, the standard of proof that a plaintiff in such an action must meet is the civil standard of proof according to a balance of probabilities as opposed to the criminal standard of proof beyond a reasonable doubt. However, in civil matters where serious allegations such as fraud or criminal conduct are made, the courts will nonetheless consider the gravity of the consequences in determining whether they are satisfied that the allegations have been proven: *Hanes v. The Wawanesa Mutual Insurance Company*[15]; *Goldshlager v. Royal Insurance Co. Ltd.*[16]; *Lomas v. DiCecca.*[17]

3.5 Applicability of Section 69

Section 69 of the Act is a "deeming provision" that was originally introduced to overcome difficulties encountered by the Crown in prosecutions under the *Combines Investigation Act*. It provides as follows:

> 69(1) In this section
>
> "agent of a participant" means a person who by a record admitted in evidence under this section appears to be or is otherwise proven to be an officer, agent, servant, employee or representative of a participant."
>
> "participant" means any person against whom proceedings have been instituted under this Act and in the case of a prosecution means any accused and any person who, although not accused, is alleged in the charge or indictment to have been a co-conspirator or otherwise party or privy to the offence charged.
>
> (2) In any proceedings before the Tribunal or in any prosecution or proceedings before a court under or pursuant to this Act,
>
> (a) anything done, said or agreed on by an agent of a participant shall, in the absence of evidence to the contrary, be deemed to have been done, said or agreed on, as the case may be with the authority of that participant;
>
> (b) a record written or received by an agent of a participant shall, in the absence of evidence to the contrary, be deemed to have been written or received, as the case may be, with the authority of that participant; and
>
> (c) a record proved to have been in the possession of a participant or on premises used or occupied by a participant or in the possession of an agent of a participant shall be admitted in evidence without further proof thereof and is *prima facie* proof
>
> (i) that the participant had knowledge of the record and its contents.
>
> (ii) that anything recorded in or by the record as having been done, said or agreed on by any participant or by an agent of a participant was done, said or agreed on as recorded and, where anything is recorded in or by the record as having been done, said or agreed on by an agent of a participant, that it was done, said or agreed on with the authority of that participant, and

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[14] (1977), 29 C.P.R. (2d) 253 (Fed. Ct. T.D.); aff'd 29 C.P.R. (2d) 255 (Fed. C.A.).

[15] [1963] S.C.R. 154.

[16] (1978), 19 O.R. (2d) 166 (H.C.J.).

[17] (1978), 20 O.R. (2d) 605 (H.C.J.).

> (iii) that the record, where it appears to have been written by any participant or by an agent of a participant, was so written and, where it appears to have been written by an agent of a participant, that it was written with the authority of that participant.

While some authors have suggested that plaintiffs are entitled to utilize this section in a civil proceeding commenced pursuant to section 36 once they have the defendants' documents through the discovery process, this would appear to result in the anomalous situation that the defendants would not have a corresponding right with respect to the plaintiffs' documents because "participant" is defined as a person "against whom" not "by whom" proceedings under the Act were instituted. The section may be subject to challenge pursuant to section 15 of the Canadian *Charter of Rights and Freedoms* on the grounds that such a result violates an "individual's" right to be "equal before and under the law and ... the right to the equal protection and equal benefit of the law."

It is also questionable whether defendants are able to take advantage of the presumption contained in this section in respect of their own documents. It may be this section would not be available to either party in a civil case and that its use is limited to the Crown. This was the approach adopted by Mr. Justice Pennell in *R. v. Canadian General Electric Co. Ltd.*[18] and followed by Mr. Justice Brennan in *R. v. Cominco Ltd.*,[19] where they refused to permit the defendants to take advantage of the presumptions in this section in respect of their own documents.

In the criminal context, some authorities suggest that subsection 69(2) of the Act may be contrary to section 11(d) of the Canadian Charter of Rights and Freedoms: *Regina v. Independent Order of Foresters* (No. 2).[20] Other authorities have reached the opposite conclusion: *R.L. Crain Inc. v. Couture and Restrictive Trade Practices Commission*.[21]

3.6 Privilege

As stated earlier, the applicable rules dealing with issues such as the production of documents and questions of privilege will depend upon the jurisdiction in which the action is brought. A claim for privilege that was advanced by the defendant in a subsequent civil action in respect of documents which had been prepared in connection with an inquiry conducted by the Director was upheld by the Alberta Court of Appeal in *Ed Miller Sales &*

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[18] (1976), 15 O.R. (2d) 360 at 364-66, 29 C.P.R. (2d) 1, 34 C.C.C. (2d) 489, 75 D.L.R. (3d) 664 (H.C.).

[19] [1980] 2 W.W.R. 693 at 719 - 721 (Alta. T.D.).

[20] (1986), 14 C.P.R. (3d) 254 (Ont.Dist.Ct.).

[21] (1983) 10 C.C.C. (3d) 119, (Sask. Q.B.).

Rentals Ltd. v. Caterpillar Tractors Co..[22] In this regard, Laycraft, C.J.A. stated that once the Director began to inquire whether the defendants were guilty of an offence under the Act, the litigation process could be said to be in full swing. Merely because the Director concluded its inquiry without further action did not necessarily mean that the litigation had also ceased, as civil rights of action were still available. Accordingly, documents prepared for the dominant purpose of assisting the legal advisors defend the Director's complaints were held to be privileged in a subsequent civil action.

3.7 Class Actions

In order to initiate a class action in Canada, members of a class must have a common interest and the damages sought must be for the entire class. Although the Act does not specifically provide a procedure for the commencement of class actions, such actions are available in most provinces pursuant to the Rules of Court enacted in each jurisdiction. However, some of the same difficulties would likely apply in the case of a class action sought to be brought under section 36 that existed in *Naken v. General Motors of Canada Limited*[23] where the Supreme Court of Canada upheld the striking out of a Statement of Claim in respect of a class action brought on behalf of Firenza purchasers. This decision was distinguished by the Alberta Court of Appeal in *Alberta Pork Producers Marketing Board v. Swift Canadian Co. Ltd.*[24] who refused to strike a Statement of Claim in respect of a class action brought on behalf of all pork producers pursuant to section 31.1 and at common law on the basis of an alleged conspiracy. Nonetheless, the scope for class actions is still limited. However, if the doctrine of issue estoppel continues to develop along the lines enunciated in *Bjarnarson v. Government of Manitoba*,[25] and *Saskatoon Credit Union Ltd. v. Central Park Enterprises Ltd.*,[26] then multiple plaintiffs may be able to utilize the doctrine of issue estoppel to take advantage of a finding of liability against a defendant in a prior civil or criminal action in which they did not participate which arose out of the same conduct.

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[22] (1988), 61 Alta. L.R. (2d) 319.

[23] (1983), 46 N.R. 139.

[24] (1984), 53 A.R. 284 (leave to appeal to the S.C.C. refused).

[25] *Supra*, note 12.

[26] *Supra*, note 11.

4.0 REMEDIES

The wording of subsection 36(1) suggests that the relief that can be awarded pursuant to this section is limited to an award of special damages in "an amount equal to the loss or damage proved to have been suffered" by the plaintiff and that no equitable relief or general, aggravated, exemplary or punitive damages can be awarded by the court in such an action. This is quite different from the situation in the United States where treble damages and injunctive relief are available pursuant to sections 4 and 16 of the *Clayton Act (1914)*.[27]

The interpretation that subsection 36(1) is limited in this manner has received judicial recognition. In *ACA Joe International v. 147255 Canada Inc.*,[28] Collier, J. expressed the view that the predecessor of subsection 36(1) was confined to damages and did not include injunctive relief. Monnin, J. in *Westfair Foods v. Lippens*[29] indicated that he would have been inclined to strike the plaintiff's claim for relief in the nature of general damages, exemplary damages and a mandatory injunction if the proceeding had been limited to the statutory cause of action. However, he did not do so as the Statement of Claim also alleged the torts of conspiracy and unlawful interference with economic interests. More recently, Reed, J. in *Industrial Milk Producers v. B.C. Milk Board*,[30] noted that she would not be inclined to strike out a claim for declaration or injunctive relief on the basis that section 31.1 provides for an award of damages because whether equitable forms of relief are available was a "debatable legal issue."

Interlocutory injunctions have been granted in some instances, for example, in *Willey v. McLaughlin*[31] in connection with a claim for damages for common law conspiracy and based on alleged violations of the Act and in *Jabour v. Law Society of British Columbia*.[32] An interlocutory injunction was granted by the Federal Court on a consent basis in *Beamscope Canada Inc. v. Aviva Software Corp.*.[33]

In some types of actions such as those based on the double ticketing or price discrimination provisions, it is anticipated that calculation of the "loss or damage proved to have been suffered" by a plaintiff would be reasonably straightforward. However, with respect to actions based on other provisions such as conspiracy or resale price maintenance, it will likely be more difficult to establish what loss the plaintiff in fact suffered.

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[27] 38 Stat. 730, 15 U.S.C.A. 2-27.

[28] (1986), 10 C.P.R. (3d) 301 (Fed. Ct. T.D.).

[29] (1987), 49 Man. R. (2d) 220 (Q.B.).

[30] *Supra*, note 7.

[31] (1976), 49 C.P.R. (2d) 86 (B.C.S.C.).

[32] (1978), 34 C.P.R. (2d) 145 (B.C.S.C.).

[33] (1987), 18 C.P.R. (3d) 100.

To date few Canadian courts have yet had to grapple with assessing damages in an action brought pursuant to section 36. In *Graff v. Midwest Motors (1966) Ltd.*,[34] the Plaintiff recovered damages of approximately $200 which represented the loss he suffered as a result of a car dealer failing to carry out his advertisement that purchasers of a vehicle would receive a television set. No damages were found to have been suffered in another misleading advertising case, *Petley v. Amhom Constructions Ltd.*.[35] A helpful discussion of some of the considerations that should be taken into account when assessing damages is contained in an article by Bruce McDonald.[36]

It is anticipated that Canadian courts will consider American authorities to assist them in dealing with some of these issues. In fact, in *City National Leasing*, Dickson stated:

> Although there are differences between s. 31.1 and the American civil action provisions, including the award of treble damages under American law, in my view the American Antitrust experience should not be overlooked.[37]

The costs associated with proceeding with a private damages action could be very substantial. Subsection 36(1) does permit the possibility of full recovery on a solicitor and client basis as the costs of a civil action are left to the trial judge's discretion up to a maximum of "the full cost to him of any investigation in connection with the matter and of proceedings under this section." However, historically courts are usually reluctant to award costs on this basis except in exceptional circumstances.

5.0 COMMON LAW ALTERNATIVE REMEDIES

The enactment of section 36 of the Act does not purport to eliminate any of the common law causes of action arising out of the same conduct. Common law remedies that may be available in some circumstances include an action based on the doctrine of restraint of trade or tort actions for civil conspiracy, unlawful interference with economic interests, intimidation or inducing breach of contract. In fact, section 62 of the Act specifically

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34. Unreported decision of the Saskatchewan Small Claims Court, May 10, 1978.

35. (1982), 67 C.P.R. (2d) 212 (Middlesex Small Claims Court).

36. Bruce C. McDonald, "Private Actions and the Combines Investigation Act" in J.R.S. Prichard et al. (eds.) *Canadian Competition Policy: Essays in Law and Economics* (Toronto: Butterworths, 1979), pp. 195-215.

37. (1989) 93 N.R. 326 at p. 378.

provides: "Except as otherwise provided in this Part, nothing in this Part shall be construed as depriving any person of any civil right of action."

The importance of the availability of common law relief should be emphasized because, as discussed earlier, equitable relief may not be available in an action brought solely pursuant to section 36 of the Act. However, in some cases while a plaintiff, may be able to establish its case under section 36 they may not be unable to prove all of the necessary elements of the common law torts. This was acknowledged by the Manitoba Court of Appeal in *Westfair Foods Ltd. v. Lippens Inc.*.[38] The Court concluded that there could be an independent civil cause of action for unlawful interference with economic interests and for common law conspiracy founded, in part, upon an alleged breach of one of the criminal provisions of the Act and that the special damages remedy contained in section 36 was merely supplementary to any existing remedies that might be available in connection with an alternate claim based on a common law tort.

6.0 INTERVENTION IN PROCEEDINGS BEFORE THE COMPETITION TRIBUNAL

Private parties have no independent right of action in respect of the "reviewable transactions" contained in Part VIII of the Act. However, through the intervention mechanism, private parties can have input in respect of such applications that are brought before the Competition Tribunal by the Director. The transactions and practices governed by this Part are not criminal offences nor are they absolutely prohibited. However, the legislation recognizes that in some situations these restrictive trade practices or mergers may have an unacceptable anti-competitive impact in certain markets. As a result, these transactions are permissible except where the Competition Tribunal, upon an application that can only be brought by the Director, concludes that the conduct has the anti-competitive impact prescribed in each section and orders remedial action. It is only where such an Order is made and is not complied with that civil damages pursuant to section 36 in respect of these transactions can arise. These reviewable transactions include:

- refusal to deal (s. 75);
- consignment selling (s. 76);
- exclusive dealing or tied selling (s. 77);
- abusive dominant position (s. 78 and 79);
- delivered pricing (s. 80 and 81);
- compliance with foreign judgments, laws or directives (s. 82 and 83);
- refusal to supply by a foreign supplier (s. 84);
- specialization agreements (s. 85 to 90); and

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[38] (1990) 61 M.R. 282; (1990) 65 M.R. 80 (leave to appeal to SCC denied).

- mergers (s. 90 to 103).

If the Director proceeds with an application under this Part before the Competition Tribunal, interested persons can seek leave from the Competition Tribunal to intervene " ...to make representations relevant to those proceedings in respect of any matter that affects that person" pursuant to subsection 9(3) of the *Competition Tribunal Act*.[39]

The Supreme Court of Canada in *Air Canada v. American Airlines*[40] upheld the Federal Court of Appeal's determination[41] that the specific role for intervenors would be a matter for the Competition Tribunal's discretion depending on the circumstances of each case and could involve full participation including the right to discover, the calling of evidence and the cross-examination of witnesses. While intervenors will play a secondary role to that of the Director, parties affected by the conduct of their competitors, customers or suppliers have the opportunity through this mechanism to present their concerns directly to the Competition Tribunal.

The Federal Court of Appeal dismissed an appeal from the Competition Tribunal's grant of intervenor status to a competitor in the Director's application pursuant to section 78 of the Act based on an alleged "abuse of dominant position" by the NutraSweet Company.[42] The Court held that the appellant had not established that the Competition Tribunal had erred in principle in exercising its discretion.

The procedure for applying to intervene is outlined in Rules 24 - 28 of the *Competition Tribunal Rules*.[43] To date few applications for leave to intervene have been denied by the Tribunal.

Where the Director is seeking a Consent Order from the Competition Tribunal at the outset of his application, persons also have an opportunity to file their comments with the Competition Tribunal pursuant to Rule 35 of the *Competition Tribunal Rules*. This procedure was utilized in the Asea Brown Bovari Inc. decision.[44]

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[39] S.C. 1986, c. 26, as amended.

[40] (1989), 92 N.R. 320.

[41] (1988), 89 N.R. 241. See also *Canadian Competition Policy Record*, Vol. 9(3), 1988, pp. 1-3; Vol. 9(4), 1988, pp. 2-3.

[42] Actions A-495-89 and A-570-89, Unreported decision of December 19, 1989.

[43] SOR/87-1252.

[44] Competition Tribunal, "Reasons for Consent Order Dated June 15, 1989" re DIR and Asea Brown Boveri Inc. et al., CT-89/1.

7.0 COMPELLING AN INQUIRY

If a private party believes that a criminal offence under Part VI of the Act has been committed or that there are grounds for the Director applying to the Competition Tribunal for an Order in respect of a reviewable transaction under Part VIII, an informal approach can be made to the Bureau. If the Bureau is not prepared to take action, the Director can nonetheless be compelled to commence an inquiry by virtue of sections 9 and 10 of the Act if six Canadian residents file a Statutory Declaration outlining the nature of the complaint, the persons concerned and the evidence supporting their opinion. Persons who cause an inquiry to be conducted are entitled, upon written request, to be informed as to the progress of the inquiry.

8.0 CONCLUSION

In summary, private parties are afforded a significant role in the enforcement of Canadian competition law. It is expected that the recent clarification of the constitutional validity of section 36 will give rise to wider use of this statutory cause of action as part of the overall structure for the regulation of competition in this country. However, without treble damages, access to equitable relief and with greater restrictions on the use of contingency fees, it is not anticipated that this statutory cause of action will be as widely used as its American counterpart.[45] The potential for broad rights of participation to be afforded to intervenors in applications brought by the Director before the Competition Tribunal will also affect the scope and nature of those proceedings.

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[45] See the discussion in Stanbury's paper in Part 2 of this volume; for the U.S. perspective, see Latimer's paper in Part 9 of this volume.

Chapter 32

PRIVATE ENFORCEMENT OF THE ANTITRUST LAWS IN THE UNITED STATES - IS REFORM CALLED FOR?

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1.0 INTRODUCTION

Before dealing with the question of whether reform is called for in the private enforcement of the antitrust laws in the United States, it is well to mention briefly the peculiarly important position which the antitrust laws have occupied since their adoption. As the Supreme Court has put it in 1958:

> The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions.[1]

Thus, the major antitrust statute is viewed not only as an economic measure but as a broader instrument of political and social policy. The result has been that while the antitrust laws have been expanded from time to time, periodic attempts in Congress to restrict or modify them have been notoriously unsuccessful.

Private enforcement of the antitrust laws through treble damage actions has been an integral part of the antitrust scene in the United States from its beginnings in 1890. As observed frequently by the Supreme Court, private

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1. *Northern Pacific Ry. Co. v. United States*, 356 U.S. 1, 4 (1958).

actions have "play[ed] an important role in penalizing wrongdoers and deterring wrongdoing."[2] Any attempt to restrict significantly the private enforcement aspect of the antitrust statutory scheme would be met with vigorous opposition. Indeed, it seems safe to predict that unless the case for reform were an overwhelming one, it would not succeed.

2.0 CRITICISM AND CONCERN

The mounting criticism and concern in the United States in recent years about the nature, volume, and consequences of private antitrust litigation must be viewed against this background.

> Many critics argue that there has been a private antitrust explosion, with the treble damages remedy partially responsible. Moreover, these critics contend that the treble damages remedy encourages interminable litigation and nuisance suits, gives plaintiffs the power to extort large settlements, and too often deters efficient, procompetitive business behavior."[3]

With an average of almost 1500 cases per year filed during the 1975 to 1980 period, and recoveries occasionally exceeding $100 million, critics claimed that fear of the treble damage "bonanza" deterred companies from, among other things, adopting innovative manufacturing techniques and distribution procedures.

2.1 Georgetown Project

While it would be difficult to prove or disprove such *ad terrorem* criticism, a significant and productive response to the concerns about private antitrust enforcement was the initiation of the Georgetown Private Antitrust Litigation Project in 1983. With a number of prominent lawyers and academics overseeing the project, a data base was compiled consisting of all private antitrust cases filed from 1973 through 1983 in five key federal districts: Southern District of New York (Manhattan); Northern District of Illinois (Chicago); Northern District of California (San Francisco); Western District of Missouri (Kansas City); and Northern District of Georgia (Atlanta). Nearly 2000 non-multidistrict litigations or approximately one-sixth of the total number of all private antitrust cases filed in the United States during that ten-year period were surveyed and analyzed.

The critics found some grist for their mill in the Georgetown data since it revealed that more than 35% of the cases had been brought by dealers and distributors and more than 30% had been initiated by competitors -- the types of cases found to be least justifiable economically by many lawyers and economists. Thus, two leading critics of the treble damage action were able to conclude that

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[2] *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 485 (1977).

[3] Salop and White, "Economic Analysis of Private Antitrust Litigation," 74 *Georgetown Law Journal* 1001 (1986).

> over three-fourths of the treble damage litigation was of an economic character where economists potentially would not expect efficiency-enhancing consequences if the plaintiffs prevailed . . . . Our assessment is that only a minority of cases in the [Georgetown] data set, and presumably in private antitrust generally, have any connection with improving or maintaining competition.[4]

But, the Georgetown data also revealed a significant trend which some of the critics overlooked, namely, an increase in the granting of defendants' motions for summary judgment and motions to dismiss. As Professor Calkins noted, there were more summary judgments for defendants in the 1978-1983 period than in the earlier 1973-1977 time frame, and, somewhat surprisingly, summary judgment was granted more frequently for defendants in antitrust cases than in other types of cases.[5] As an appropriate rejoinder to the critics, the greatest success rate for defendants in obtaining summary judgment was in terminated dealer cases. There was also a high rate of dismissal and summary judgment for defendants in cases brought by competitors.[6]

This increase in the summary dismissal of treble damage actions can be attributed to another key feature of the *Sherman Act* -- the flexibility and adaptability of the term "restraint of trade." As the Supreme Court has emphasized, "[t]he changing content of the term 'restraint of trade' was well recognized at the time the *Sherman Act* was enacted.... the earlier doctrine of the common law has been substantially modified in adaptation to modern conditions."[7]

2.2 Chicago School

Beginning in the 1970's, the so-called Chicago school, advocating a more economically conservative antitrust jurisprudence, came increasingly to the fore. In particular, the great weight of scholarly opinion came to view favorably the economic utility of vertical restraints in promoting interbrand competition. In 1977, the Supreme Court in the *Sylvania* case demonstrated the "adaptability" of the *Sherman Act* by accepting this widely held scholarly view and reversed the ten-year old ruling that non-price vertical restraints were *per se* violations of the *Sherman Act*.[8]

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[4] Elzinga and Wood, "The Costs of the Legal System in Private Antitrust Enforcement" in L.J. White (ed.) *Private Antitrust Litigation* (Cambridge, Mass.: MIT Press), at p. 134.

[5] Calkins, "Summary Judgment, Motions to Dismiss, and Other Examples of Equilibrating Techniques in the Antitrust System," 74 *Georgetown Law Journal*, 1130, 1136 (1986).

[6] *Ibid.* at 1134-36.

[7] *Business Electronics Corp. v. Sharp Electronics Corp.*, 108 S.Ct 1515, 1523 (1988).

Since the *GTE Sylvania* decision, only two courts of appeal decisions have held that a vertical customer or territorial restraint was unlawful. In one instance, a 70 percent market share was involved,[9] and in the other, the defendants' asserted justification was found to be a pretext for a horizontal combination.[10]

The increase in summary judgment dismissals attributable to *GTE Sylvania* can be seen from the fact that federal courts of appeal regularly grant summary judgment to defendants in non-price vertical restraint cases unless the plaintiff can establish defendant's market power (defined as the unilateral ability to raise prices without regard to competition), and the courts have gone on to rule that a less than substantial market share (less than 30-40 percent) is a surrogate for a lack of market power.

2.3 Recent Cases

Continuing to "adapt" the *Sherman Act* to current economic thinking, the Supreme Court also has made it more difficult for plaintiffs to withstand summary judgment in both vertical and horizontal price conspiracy cases brought by distributors and competitors. Thus, in *Monsanto Co. v. Spray-Rite Service Corp.*, the Court went to considerable lengths to emphasize that there must be "evidence that tends to exclude the possibility that the manufacturers and nonterminated distributors were acting individually" even in vertical price fixing conspiracy cases.[11] Otherwise, the Court left no doubt that summary judgment should be granted.

In particular, the Court in *Monsanto* saw a threat to its *GTE Sylvania* holding if an inference of concerted action based upon a manufacturer's receipt of distributor complaints about other price-cutting distributors were allowed to defeat summary judgment.

> (I)t is of considerable importance that independent action by the manufacturer, and concerted action on non-price restrictions, be distinguished from price fixing agreements, since under present law the latter are subject to *per se* treatment and treble damages.... If an inference of [a price fixing] agreement may be taken from highly ambiguous evidence, there is a considerable danger that the doctrine enunciated in *Sylvania* and *Colgate* will be seriously eroded... 'to permit the inference of concerted action on the basis of receiving complaints alone and thus to expose

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[8] *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977).

[9] *Graphic Prods. Distributors, Inc. v. Itek Corp.*, 717 F.2d 1560 (11th Cir. 1983).

[10] *Eiberger v. Sony Corp. of America*, 622 F.2d 1068 (2nd Cir. 1980).

[11] *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 764 (1984).

> the defendant to treble damage liability would both inhibit management's exercise of its independent business judgment and emasculate the terms of the statute'.[12]

The Court took it a step further in the recent *Matsushita*[13] case, holding that summary judgment should have been granted where a horizontal predatory pricing conspiracy was alleged by a competitor. "There is little reason to be concerned that by granting summary judgment in cases where the evidence of conspiracy is speculative or ambiguous, courts would encourage such conspiracies."[14]

Additionally, in the area of standing, the Supreme Court has put further limits on private plaintiffs' ability to bring antitrust treble damage actions. After the *Illinois Brick* decision in 1977, only direct purchasers from allegedly price fixing suppliers are entitled to sue.[15] And in 1983, the Supreme Court promulgated even stricter antitrust standing requirements generally.[16] Even before these more recent cases, licensors, franchisers, and lessors who are foreseeably injured by illegal conduct, were regularly denied standing in antitrust actions as courts searched for the "appropriate" antitrust enforcer. In contrast, "proximate cause" ordinarily is a question of fact for the jury while antitrust standing, with all its restrictions, is decided as a matter of law by the court.

Finally, stringent limitations have been put on plaintiffs in private actions seeking injunctions or damages for mergers allegedly lessening competition.[17] For example, in the leading *Brunswick* case, several bankrupt bowling centers were purchased by the largest United States operator of bowling centers, and plaintiff claimed that if the defaulted bowling centers had closed down, its profits would have increased. The Supreme Court ruled that this loss did not occur "by reason" of that which made the acquisition unlawful, i.e. Brunswick's deep pocket, since the same loss to plaintiff would have occurred if the centers had been purchased by a shallow-pocket parent.

Further studies have shown that federal courts of appeal increasingly have voted conservatively in antitrust cases in the last few years following the more restrictive decisions by the Supreme Court. In fact, as analyzed in a recent study, both Carter and Reagan appointees to the courts of appeal have voted conservatively in antitrust cases in the last ten years: 72.9% for Carter appointees and 78% for Reagan appointees.[18] In the study in question, a "conservative" voting position holds a permissive view toward single-firm conduct (i.e. predatory pricing), shared monopolization and market signalling, vertical restraints, mergers (except horizontal transactions involving large market shares), and price discrimination. Once again, these are the types of cases about which critics of the private antitrust "explosion" have complained the most.

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[12] *Ibid.* at 763-64.

[13] *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

[14] *Ibid.* at 595.

[15] *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977).

[16] *Associated General Contractors of California, Inc. v. California State Council of Carpenters*, 459 U.S. 519 (1983).

[17] *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, *supra*, note 2; *Cargill, Inc. v. Montfort of Colorado, Inc.*, 479 U.S. 104 (1986).

2.4 Number of Cases

Perhaps most significantly, the acceptance of a more economically conservative antitrust jurisprudence by the Supreme Court and by the lower federal courts has resulted not only in an increase in the pretrial disposition of private antitrust cases, but in a dramatic decline in the number of private antitrust cases that have been filed. See Table 1.

Overall, the number of private antitrust cases initiated in 1989 fell from 1611 in 1977 to 638 in 1989.[19] But note that the ratio of private to total public and private cases fell far less. A number of types of cases that once were routine no longer are brought. For example, it has been apparent to antitrust practitioners for some time that plaintiffs generally cannot win dealer termination cases or predatory pricing cases and they are not being filed. The almost inescapable conclusion is that many, if not most, of the economically "harmful" private antitrust cases have disappeared out of the system or are being disposed of by pretrial motion.

Another factor that appears to have contributed to the decline in the number of private antitrust cases filed in recent years also is revealed by the Georgetown data. The number of private antitrust cases filed in the wake of Department of Justice criminal cases declined significantly in the 1978-1983 period as compared to 1973-1977.[20] Table 1 indicates that the total number of criminal and civil cases filed by the Department of Justice fell from an average of 105 p.a. in the first half of the 1980s to 94 p.a. in the second half. This, in turn, is due to the fact that after 1978, most government cases involved alleged bid-rigging by small companies in businesses such as electrical contracting, asphalt paving, and other small business industries not likely to give rise to private actions for treble damages. This decline in the number of criminal antitrust cases brought against large companies in the United States coincided with the application of increased individual and corporate fines and the raising of the maximum jail sentence for individual antitrust violators from one to three years.[21]

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[18] Kovacic, "The Reagan Judiciary Examined: Comparison of Antitrust Voting Records of Carter and Reagan Appointees to the Federal Courts of Appeals," Washington Legal Foundation (1989).

[19] Figures for 1976 (n = 1504) and 1977 (n = 1611). Annual Reports of the Director of the Administrative Office of the United States Courts, 1976-1977.

[20] Kauper and Snyder, "An Inquiry Into the Efficiency of Private Antitrust Enforcement: Follow-on and Individually Initiated Cases Compared," 74 *Georgetown Law Journal* 1178 (1986).

Whether or not it shows the deterrent effect of increased penalties on the conduct of larger firms (which presumably receive more and better legal advice than smaller firms), the decrease in the number of criminal antitrust cases against larger firms has helped to bring about the sharp reduction in the number of private antitrust cases filed in recent years.

A final argument made by those advocating curtailment of private actions is that the length and complexity of such cases clogs U.S. federal courts to an intolerable degree. Once again, the Georgetown data is revealing. Of the 2,000 cases analyzed, the average private antitrust proceeding lasted approximately two years. This compares to annual data compiled for federal court cases generally showing that the typical case lasts only slightly less than 18 months.[22] Moreover, even at the height of the antitrust boom, private antitrust cases constituted a tiny fraction of all civil cases filed in the federal courts. Significantly, as discussed above, while the number of private antitrust cases decreased substantially, all civil cases filed in the federal courts increased from 96,000 in 1973 to 273,670 in 1985.[23] This has declined somewhat to 239,634 in 1988 but any "congestion" due to antitrust cases clearly is not a problem.

In sum, the adaptability of the *Sherman Act* to changed circumstances, which has permitted accommodation with the modern economic consensus, demonstrates the wisdom of not doing away with the private action enforcement system or with substantially modifying it. Any permanent modification or curtailment would not allow a similar flexible response to the next change in circumstance, which almost surely will come.

3.0 REFORMS

There are, however, some modest changes that could improve the system. First, the joint and several liability of all defendants should be changed. Defendants should be liable in antitrust actions individually rather than jointly and there should be due regard for size of company, market share, and degree of culpability. Secondly, barring the unlikely event that juries are abolished in antitrust cases, as some have advocated, they at least ought to be informed that any damage award would be trebled. At present, juries are kept in the dark on this key provision.

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[21] *Antitrust Procedures and Penalties Act*, 15 U.S.C. § 1 (1982).

[22] Salop and White, *supra*, note 3 at 1016.

[23] See note 19, *supra*.

Finally, some commentators have advocated giving the district courts discretion to select the multiplier depending upon the seriousness of the violation. For example, one proposal has been to give the judge discretion to impose less than treble damages if he finds, in a non-*per se* case, that a defendant "reasonably believed" that a given action or transaction did not violate the antitrust laws.[24] However, it is likely that such discretion would cause more problems than it solves by way of increasing insecurity and discouraging settlements once disputes have arisen.

On balance, it seems better to keep the present flexible system of private treble damage enforcement which can accommodate change but which serves to compensate injured parties and to deter antitrust violations in conjunction with government criminal and civil enforcement. There will always be some cases in which plaintiffs misuse the private action to seek a competitive advantage or an unjustified monetary recovery, and which are not ferreted out by pretrial motions. But the case has not been made to change a proven, flexible system which can accommodate new thinking in the analysis of what constitutes pro and anti-competitive behavior.

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[24] Goldschmid, "Comment on the Policy Implications of the Georgetown Study" in L.J. White (ed.) *Private Antitrust Litigation* (Cambridge, Mass.: MIT Press), at p. 415.

Table 1

Antitrust Cases Filed by the Antitrust Division, Federal Trade Commission, and Private Parties in U.S. District Courts During the 12 Months Ending June 30, 1980 to 1989

		U.S. Cases[1]			
Year	Total cases	Civil cases	Criminal cases	Private cases	Private cases as a percent of total
1980	1,535	39	39	1,457	94.9
1981	1,434	60	82	1,292	90.1
1982	1,148	29	82	1,037	90.3
1983	1,287	21	74	1,192	92.6
1984	1,201	24	77	1,100	91.6
1985	1,142	30	60	1,052	92.1
1986	922	39	45	838	90.9
1987	858	27	73	758	88.3
1988	752	28	70	654	87.0
1989	737	19	80	638	86.6
Total	11,016	316	682	10,018	90.9

1. Number filed by Antitrust Division and FTC.

Source: U.S. General Accounting Office, *Justice Department: Changes in Antitrust Enforcement Policies and Activities* (Washington, D.C.: GAO/GGD-91-2, October 1990), p. 15.

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